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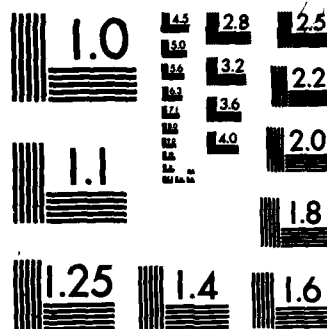
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THESIS

AN ANALYSIS OF THE FINANCIAL
INVENTORY REPORTING STRUCTURE

by

Jack E. Shick

December, 1982

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1. REPORT NUMBER	2. GOVT ACCESSION NO. AD 4126 618	3. RECIPIENT'S CATALOG NUMBER
4. TITLE (and Subtitle) An Analysis of the Financial Inventory Reporting Structure		5. TYPE OF REPORT & PERIOD COVERED Master's Thesis December, 1982
7. AUTHOR(s) Jack E. Shick		6. PERFORMING ORG. REPORT NUMBER
9. PERFORMING ORGANIZATION NAME AND ADDRESS Naval Postgraduate School Monterey, California 93940		8. CONTRACT OR GRANT NUMBER(s)
11. CONTROLLING OFFICE NAME AND ADDRESS Naval Postgraduate School Monterey, California 93940		10. PROGRAM ELEMENT, PROJECT, TASK AREA & WORK UNIT NUMBERS
14. MONITORING AGENCY NAME & ADDRESS (if different from Controlling Office)		12. REPORT DATE December, 1982
		13. NUMBER OF PAGES 208
		15. SECURITY CLASS. (of this report)
		15a. DECLASSIFICATION/DOWNGRADING SCHEDULE
16. DISTRIBUTION STATEMENT (of this Report) Approved for public release; distribution unlimited		
17. DISTRIBUTION STATEMENT (of the abstract entered in Block 20, if different from Report)		
18. SUPPLEMENTARY NOTES		
19. KEY WORDS (Continue on reverse side if necessary and identify by block number) Financial Inventory Reporting Inventory Accounting		
20. ABSTRACT (Continue on reverse side if necessary and identify by block number) This thesis presents a detailed analysis of the Financial Inventory Reporting Structure currently in use by Navy for stores account material in light of the problems uncovered by the Naval Audit Service in their report dated January 1979. The existing structure is described and analyzed at both the stock point and the central accounts level maintained by the Navy Regional Finance Center, Washington, D.C. In addition, the		

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An Analysis of the Financial
Inventory Reporting Structure

by

Jack E. Shick
Lieutenant Commander, SC, United States Navy
B.S., United States Naval Academy, 1973


Submitted in partial fulfillment of the
requirements for the degree of

MASTER OF SCIENCE IN MANAGEMENT

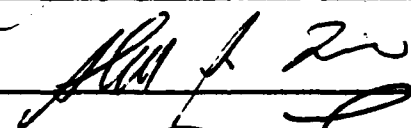
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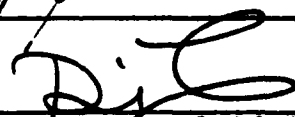
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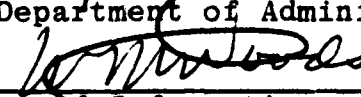
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ABSTRACT

This thesis presents a detailed analysis of the Financial Inventory Reporting Structure currently in use by Navy for stores account material in light of the problems uncovered by the Naval Audit Service in their report dated January 1979. The existing structure is described and analyzed at both the stock point and the central accounts level maintained by the Navy Regional Finance Center, Washington, D.C. In addition, the effects of the structure on inventory management are explored and discussed. The Thesis identifies and isolates the level of detail required for the system to fulfill both external reporting and internal management control requirements. This analysis is conducted through a detailed exploration of the stated objectives of the system. Results of this analysis identify an ability to significantly reduce the system's complexity. Finally, a proposal for system modification is presented which could enable Navy to continue to fulfill its objectives with a significantly less complex system structure.

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I. INTRODUCTION

A. PURPOSE

"The Financial Inventory Reporting System is so replete with errors that it conforms to its stated goals in form only vice substance." This stinging comment was a major finding of a report issued by the Naval Audit Service in January 1979. The subject of the report was a three year investigation conducted by the Naval Audit Service on the procedures, effectiveness, and efficiency of the Financial Inventory Reporting structure utilized by the Naval Service.

The major recommendation issued by the Audit Service was; "the inventory system should be revised with a view toward developing a more meaningful and direct control system, that would provide more accurate and meaningful data for Naval Supply Systems assets." In other words, the structure presently utilized for Financial Inventory Reporting was found too complex to be accurately maintained and managed. Simplification of the system was greatly needed if the system was to continue to operate with any effectiveness at all. In this light, the main purpose of this thesis will be to analyze various alternatives that would allow the system to operate in a much simpler manner. However, prior to the redesign or modification of any system, the basic objectives of that system must be identified and provisions

made for their inclusion in any subsequent design decisions. Therefore, the alternatives for simplification of the system can be developed only after the basic objectives of the system are described. This would indicate the necessity to identify a secondary purpose of the thesis: the identification of the major objectives of the Financial Inventory Reporting structure, how the present structure meets or fulfills those goals, and what level of information is required to meet those objectives. Once this is accomplished, it is only a short step to the development of alternatives for system modification that will simplify the present structure.

B. SCOPE

The Financial Inventory Reporting structure is utilized at various organizational levels throughout the Naval Service. The reports are used at the activity level to provide financial information on stock levels, transactions, and adjustments made to the inventory accounts. It is also utilized by the Navy Regional Finance Center, Washington, D.C., which acts as the central accounting office for the Navy, in compiling the details of each inventory account. These details are subsequently used for the preparation of external reports similar to the balance sheet and income statement utilized by private industry. Finally, the structure is utilized by inventory managers in making procurement and budgeting decisions on the inventory items under their cognizance.

In addition to the purposes discussed above, the Financial Inventory Reporting structure is designed to fulfill the requirements of law as established by the National Security Act of 1947 as specified by Department of Defense Instruction 7420.11. The scope of this thesis is across all organizational levels and all stated goals of the system as contained in NAVCOMPT MANUAL 034000.2. These goals will be discussed in greater detail in Chapter 2 and indeed will become the major thrust of the analysis.

C. METHODOLOGY

The first problem inherent within the development of this thesis is an identification of the present Financial Inventory Reporting structure. Although the major portion of the procedures on how the system functions are contained in NAVCOMPT Volume III Chapter 4, identification of these procedures is by no means an easy task. Detailed instructions for many of the coded accounts contained within that chapter are nonexistent, confusing, or contained in other comptroller or supply manuals. Consequently, a great deal on how the system actually functions is not contained directly within the manual and had to be obtained from personnel experienced in the operation of the system.

Once the functions of the system were identified and documented, an analysis was performed on how the system met its objectives. This analysis coupled with an identification

of the minimum level of detail required to meet these objectives permitted the development of alternatives that would in turn permit system simplification. Two specific classifications of objectives became apparent: 1) legal requirements and governing regulations and 2) implicit requirements (which were in essence internal management requirements). The legal requirements were analyzed by a comparison of the present FIR structure with the requirements for inventory accounting and reporting as established by the Department of Defense in a detailed description of a chart of accounts. The implicit requirements were analyzed by identifying the information required from the system in order to perform stock record reconciliation and budget submission and monitoring. As each area was developed, specific concepts were identified that would permit simplification of the system through modification.

D. THESIS ORGANIZATION

Chapter 2 presents a detailed description of the present Financial Inventory Reporting structure. In addition to providing a basis from which the analysis of this thesis can be developed, Chapter 2 was also written to provide the uninitiated reader with the basic concept of the system. Chapter 3 and 4 contain the analysis of the system. Chapter 3 identifies the legal requirements of the system, examines how the present FIR structure functions within that system,

and makes recommendations for system improvement. Chapter 4 develops the same basic analysis for both the stock record reconciliation process and the budgetary requirements of the system. Finally, Chapter 5 summarizes these conclusions and briefly outlines a proposed system for future adoption.

E. ENVIRONMENT

As stated within the main body of this thesis, the FIR structure has been under the scrutiny of many organizations within the Navy since the Naval Audit Service first issued its report. Since the initial research for this thesis began in June 1982, many major changes have been instituted within the present structure. The major thrust of many of these modifications appear to be consistent with the conclusions developed herein. This thesis then is offered as both an additional independent study to help justify the changes already incorporated as well as a guide to future modifications.

II. THE PRESENT FINANCIAL INVENTORY REPORTING SYSTEM

A. BACKGROUND

The Financial Inventory Reporting (FIR) structure is a system utilized by accountable Navy field activities to report the level of inventory held in stores accounts to the Navy Regional Finance Center (NRFC), Washington, D.C. NRFC Washington acts as a central accounting office for Navy inventory accounts accumulating total Navy stores account balances from inputs provided by activity reports. In addition to identifying the level of inventory, the report provides a detailed summary of transactions which have affected the inventory account during the accounting period. The accounting period for financial reporting utilized by the Navy is on a monthly basis.

There are two types of inventory stores accounts that the Navy is responsible for; the Navy Stock Fund Account (NSA) and Appropriation Purchases Accounts (APA). A stock fund is a revolving fund/working capital account established by congress for the military service charged with its maintenance. At the time of initiation, these funds are normally granted a certain monetary value which is deposited to a capital equity account, and an asset account entitled cash is established. Inventory is purchased, inventory asset accounts are incremented to maintain the value of

stock on hand, and either the cash account is decreased or liability accounts are established. When inventory is issued to customer activities, revenue accrues to the stock fund which results in a corresponding increase to an asset account; either Cash or Accounts Receivable. The original capital equity account remains unchanged throughout this process and is only altered through congressional action. Any profits or losses are accumulated in a capital account similar to retained earnings. [Ref. 1: pp. G1-G29]

In contrast to stock fund accounts, the appropriation purchase accounts are not revolving funds. Inventory levels are maintained through appropriated funding on an annual basis augmented by reimbursable sales for issues made to other than Department of Navy customers. When the annual budget is submitted each year, the drain on inventory as a result of nonreimbursable issues (essentially free issues to customer activities) is estimated and subsequently appropriated to the account. [Ref. 2]

Stock fund and appropriation inventory accounts are maintained by a central accounting office (NRFC) in Washington, D.C. in standard Balance Sheet and Income Statement format. NRFC is charged with generating detailed accounting information for subsequent reporting through other Naval commands to the Office of Secretary of Defense and Navy inventory managers on the financial condition of each inventory account. Within the Navy, the maintenance of

monetary and inventory accounting data for both stores funds and APA items is highly decentralized. Banking type transactions, which affect the level of the monetary accounts only, are reported to the central accounting office by regional Financial Information Processing Centers (FIPC). The FIPCs are responsible for bill payment and the collection as a result of reimbursable issue or sale of material by the inventory account. [Ref. 1: pp. D62-D64] Transactions that affect the inventory levels are reported by the accountable Navy field activities through the use of the FIR report submitted at the end of each month. [Ref.3]

In most instances, there will be corresponding accounting entries provided by each system. For example, when material is purchased, a decrease to the asset account cash will be reported to the central accounting office via a copy of an abstracted public voucher. (An abstracted public voucher is simply a listing of all bills paid by the regional finance office for the accountable activity.) A corresponding increase to the inventory account will be reported by the accountable activity upon submission of the FIR. In essence, the FIR is the vehicle that provides the central accounting office with financial information on inventory levels. Although it appears to be a single entry accounting system at the accountable activity level, corresponding monetary entries are being made at the same time to the accounts maintained centrally. The focus of this thesis is the

Financial Inventory Reporting (FIR) structure utilized to report inventory levels and transactions and how the information contained in this structure is utilized by the central accounting office in the development of its Balance Sheet and Income Statement.

B. GENERAL

Before exploring how the structure is utilized at the central accounting office, which is discussed under Chapter 3, it is necessary to understand the reporting structure itself. The simplest place to start any explanation of the FIR reporting structure is to view it from the activity level. Once this is accomplished, it is only a small step to understanding how the system consolidates the information provided at the activity level into summary data for the inventory account on a Navy wide basis. This section provides some general information that is necessary to understand prior to any detailed discussion of the reporting structure.

The Financial Inventory Accounting structure presently utilized by the Navy grew out of the requirements of the National Security Act of 1947. At the time of its inception, Financial Inventory Accounting and its associated reports were the only means of maintaining data on inventory stock levels. The system was devised as a manual accounting system in accordance with the Generally Accepted Accounting

Principles of the time and was considered to be a reliable source of inventory management information. The widespread utilization of data processing equipment that has since developed within the Naval Supply System in effect separated inventory accounting into two distinct structures (automated stock record maintenance and automated financial accounting) and first brought to light some of the difficulties presently experienced with the system and the reconciliation of financial and inventory stock records.

The Financial Inventory Reporting structure (FIR) represents only one side of the inventory picture in today's modern world. Automation has made possible stock record maintenance of inventory levels on hand at the appropriate warehousing location. This initiated a need to compare and reconcile differences between the financial records maintained by the accounting department and the inventory records maintained by the stocking activity. The FIR today is looked upon as both a means of validating the totals contained within actual stock records as well as the primary source of financial information on inventory levels. NAVCOMPT 034000.2 lists the following as the main purposes of Financial Inventory Accounting and Reporting:

1. to fulfill the requirements of the National Security Act of 1947 which requires that the military departments shall maintain records on material in store and requires that the Secretary of Defense report annually on such property to the President and to the Congress

2. to ensure the integrity of stock funds and to maintain similar financial safeguards over material acquired under other appropriations
3. to provide a source for the preparation of stock fund statements and status reports of appropriation financed inventories for submission to the Department of Defense
4. to furnish inventory managers with essential financial data for budgetary requirements

Inventory is carried in the financial records at a standard price established by the office, command, inventory control point, or headquarters having management responsibility for the category of material. The standard price includes the purchase price or production cost at the time of establishment, first destination transportation charges, and a surcharge to recover estimated net losses such as pilferage, damage, deterioration, inventory shortages, and excesses arising from obsolescence. Stock Fund standard prices also includes second destination transportation charges. The surcharge also includes a price stabilization factor. In its simplest form, this factor allows for the replacement of inventory during inflationary periods by adding a charge to the standard price to recover a portion of anticipated inflation between the point of purchase and the time of sale or issue. All sales or issues are made at the standard price with the following exceptions:

1. Consolidated procurements by other agencies subject to pricing contingencies in accordance with instructions issued by offices, bureaus, commands, inventory control points, or headquarters

2. Some Material in long supply
3. Sales under the Security Assistance Program
4. Depot level repairables when issued on an exchange basis will be billed at the net price
5. Some Bulk sales agreements
6. Some Interdepartmental or international sales agreements
7. Some Sales under the Mutual Security Military Program

[Ref. 3: pp. 2-4]

In general terms, the procedures for financially accounting for inventory under the FIR concept are similar to a standard cost accounting system. Receipts are added to beginning inventory at either purchase costs, production costs, or standard costs. Price variances are added or deducted based on the variation between actual and standard costs. Contra receipt and issue accounts are deducted for returned material. Net expenditures are deducted from this total to arrive at Ending Inventory. In effect, every entry is either a debit or a credit to the inventory account. The main difference between the FIR concept and standard cost accounting systems is the complex level at which information is maintained and the extensive number of financial categories involved.

C. THE FINANCIAL INVENTORY REPORTING STRUCTURE

The database from which the FIR reports are constructed are subsidiary inventory accounts which are maintained at an

extremely detailed level and coded to represent various categories of transactions. For example, FIR Account A1 (Receipts from Procurement--Commercial) is a receipt account that is established to account for a type of receipt to inventory. Since inventory is an Asset account, receipts are debited to the account A1 to reflect an increase to inventory. In contrast, entries to FIR accounts that reflect decreases to inventory such as Issues, will be credited at the time of the transaction. In other cases, material is recategorized according to the various inventory categories described below. In these cases special FIR accounts are established to reflect these changes (such as a transfer from "ready for issue" to "not ready for issue" status under condition code assignment).

In order to appreciate the level of the subsidiary accounts, it is necessary to understand how material is classified. Within each type of inventory account material is first classified by cognizance symbol. A cognizance symbol is a two digit alpha numeric code which designates the appropriate inventory manager and the type of material for which the manager has management responsibility. [Ref. 4: pp. 41-42] The cognizance symbol is the National Stock Number (NSN) used to identify each item maintained in inventory. Table I provides a sample of cognizance symbols used by Navy inventory managers. A detailed listing of the 89 cognizance symbols employed to categorize material and

identify inventory management responsibility within the Navy is contained in NAVCOMPT MANUAL Volume 3 Chapter 4.

TABLE I
SAMPLE OF COGNIZANCE SYMBOLS

<u>Cognizance Symbol</u>	<u>Inventory Manager</u>	<u>Stores Account</u>	<u>Material</u>
1B	NAVSUP	NSA	Fuel Reclamation
1H	SPCC	NSA	Navy Stock Fund assigned to SPCC for inventory management
7G	SPCC	NSA	Depot level repairable electronic re- pair parts supporting Elec- tronic Systems Command Equip- ment
9F	FMSO	NSA	Navy owned stocks of material managed by the Air Force within the Warner Robbins Air Log Center
1R	ASO	NSA	Aeronautical, photographic, and meterological material (con- sumable or expense type material)
2B	SPCC	APA	Materials handling equipment to SPCC for inventory management

Material held in each cognizance symbol is in turn classi-
fied in two separate categories: by condition code and by
material control code. The condition code is an alphabetic

code that identifies the condition of the material. [Ref. 5: pp. 117-118] Table II provides a sample of the condition codes utilized by Navy controlled cognizance symbols. Material is also categorized according to a material control code. The material control code is a single alphabetic character assigned by the inventory manager to segregate items into more manageable groups or to identify special control requirements. [Ref. 5: pp. 34-35] Table III is a brief sample of the material control codes utilized by Navy Inventory managers. Detailed listings of all condition codes and material control codes are contained in NAVSUP Manual of Supply Ashore.

TABLE II
SAMPLE OF CONDITION CODES

<u>Code</u>	<u>Title</u>	<u>Definition</u>
A	Serviceable (issuable without qualification)	New, used, repaired, or re-conditioned material which is serviceable and issuable to all customers without limitation or restriction Includes material with more than 6 months shelf life remaining
B	Serviceable (issuable with qualification)	New, used, repaired, or re-conditioned material which is serviceable and issuable for its intended purpose, but which is restricted from issue to specific units, activities, or geographical areas by reason of its limited usefulness or short service-life

E	Unserviceable (limited re- storage)	Material which involves on- ly limited expense or effort to restore to serviceable condition and which is accomplished in the storage activity where the stock is located
F	Unserviceable (repairable)	Economically repairable material which requires re- pair, overhaul, or recondi- tioning
J	Suspended (in stock)	Material in stock which has been suspended from issue pending condition classifi- cation or analysis, when the true condition is not known
K	Suspended (returns)	Material returned from cus- tomers or users and awaiting condition classification

TABLE III

SAMPLE OF MATERIAL CONTROL CODES

<u>Codes</u>	<u>Definition</u>
A	Field activity control items
B	Material (expendable ordnance) requiring lot number reporting
C	Material (expendable ordnance) re- quiring serial number reporting
D	Field level repairables (items which generally can be repaired locally, i.e. by an organizational or intermediate maintenance level activity)
E	1. Depot level repairables designated for intensive management under the Improved Repairables Asset Management (IRAM) program. 2. Material (expend- able ordnance) requiring lot and serial number control, but which is reported by serial number only

F	Fast moving cognizance symbol 1I forms
G	FBM weapon system depot level repairables requiring intensive management
H	Depot level repairables not assigned MCC E, G, Q, or X

Figure 2.1 is a graphic summary of the categorization of material maintained on the various inventory accounts. It should be readily apparent that there are numerous possible combinations of condition codes and material control codes within a given cognizance symbol. These various combinations comprise one side of the matrix of data within which the inventory accounts are maintained. For example, the combination 1B AA identifies material within cognizance symbol 1B that is serviceable and is a Field activity control item. An entire set of subsidiary inventory accounts will be maintained under this combination, as well as all other combinations within each cognizance symbol. These accounts which reflect the various transactions that occur to the inventory, comprise the other side of the matrix of data in which the inventory accounts are maintained. In essence, the vertical axis can be thought of as the FIR accounts, which reflect transaction type, and the horizontal axis can be thought of as the classification level at which the accounts are maintained. These accounts may be combined at any time to obtain the total value of each transaction

type by cognizance symbol. Cognizance symbol data may in turn be combined to provide transaction totals for each inventory account. The total contained in all cognizance symbols will always equal the total in all condition code and material control code classifications. [Ref. 3: p. 36]

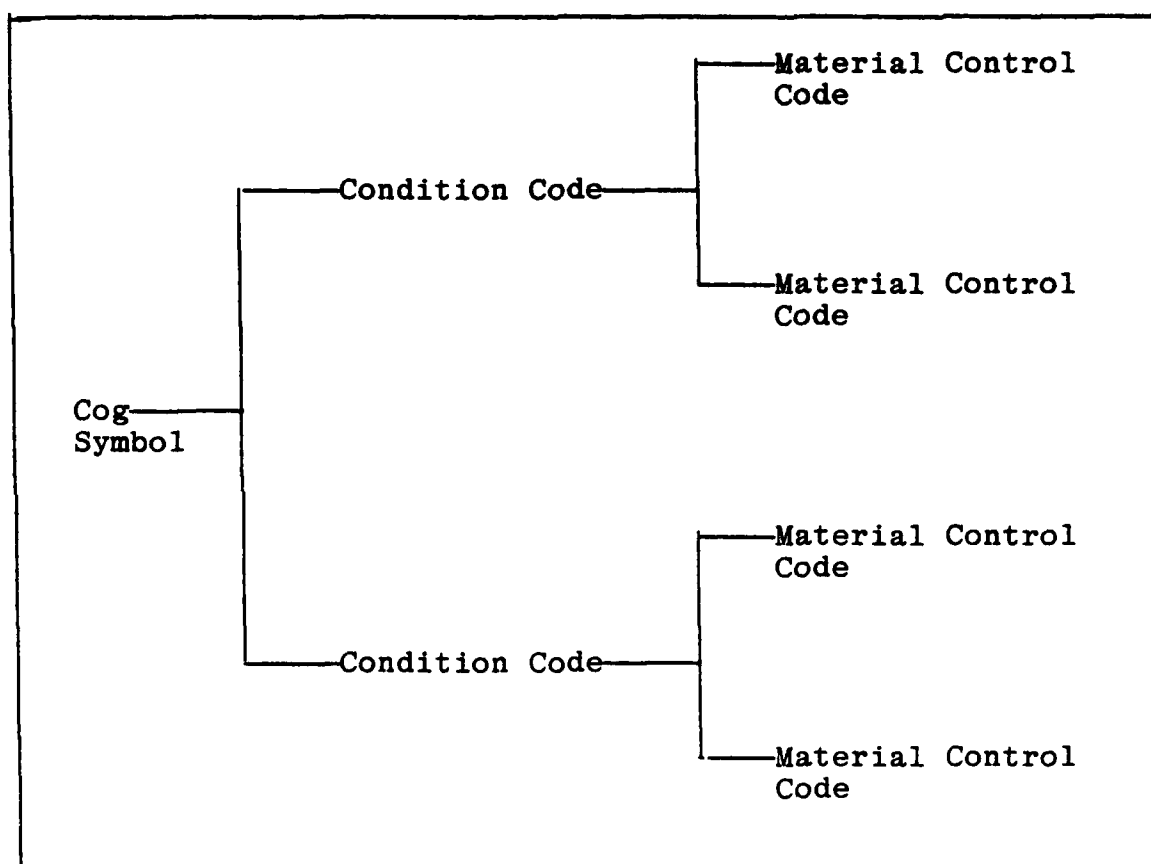


Figure 2.1 Summary of Material Classification

It is also important to note at this point the identification and maintenance of financial information pertaining to inventory held under Special Accounting Classifications, such as ready support stores or on board 207 or 224 ships. This type of material is collectively known as second

echelon of supply material. In its simplest form, the material is held by a second echelon activity, which maintains the accountability for the material, while the main store activity maintains the accounting responsibility. In cases where an activity holds accounting responsibility for second echelon inventory, the activity maintains separate accounts in the same manner as described above. These accounts are reported separately to the central accounting office. This enables the central accounting office to maintain and monitor information on the quantity of inventory on hand at second echelon activities. [Ref. 3: p. 5]

The FIR report itself is prepared from the data contained within the subsidiary accounts and is presented in relatively the same format in which the accounts are maintained. The general structure of the FIR report includes the opening and closing balances and transaction totals by FIR code. All transaction totals contained in each subsidiary account are grouped as either receipts or expenditures. Variances and adjustments which either add to or deduct from inventory are classified as either receipts or expenditures accordingly. The FIR code itself, which is the same as the database subsidiary account, details the type of transaction involved. The abbreviated report shown below in Figure 2.2 is an example of the content of information contained within the FIR.

	<u>Opening Balance</u>	<u>Receipts</u>	<u>Expenditures</u>	<u>Closing Balance</u>
H1	\$2,500			
A1		\$4,000		
A5		\$2,000		
A8		\$1,500		
B1		\$ 50		
B9		\$ 100		
C1		\$ 400		
D4		\$ 250		
E1		\$ 450		
F4		\$1,000		
J1			\$5,000	
A2			\$ 100	
K1			\$ 500	
N4			\$1,500	
L1			\$ 50	
M1			\$ 150	
M4			\$ 200	
N1			\$ 25	
P4			\$ 800	
R1				\$3,925

Figure 2.2 Sample Financial Inventory Report

The FIR report contains three separate sections.

Section 1 provides the opening balance, transaction totals by FIR code, and closing balance remaining within each inventory account (i.e. NSA , APA, etc.). This information is obtained by combining all accounts belonging to cognizance symbols contained within the inventory account being reported.

Section 2 provides the opening balance, transaction totals by FIR code and closing balance remaining at the cognizance symbol level contained within the inventory accounts. This information is obtained by combining all accounts belonging to each cognizance symbol.

Section 3 provides the opening balance, transaction totals by FIR code, and closing balance of each combination of condition code and Material Control Code contained within each cognizance symbol classification. The material contained in Section 3 is at the same depth maintained within

the subsidiary inventory accounts which are described in the following sections. [Ref. 3: p. 36]

D. OPENING INVENTORY

The opening balance of the inventory account is maintained in the Financial Accounting Records under FIR account H1. The balance in H1 represents the inventory on hand at the beginning of the accounting period and must agree with the total contained in the closing inventory of the previous period. The value of this account will not change during the accounting period which is one month in duration. [Ref. 3: p. 33]

E. RECEIPTS

There are basically five different types of transactions that occur to the inventory at the activity level: receipts, expenditures, recategorizations, revaluations, and physical adjustments. The following sections attempt to outline the basic procedures of the FIR in handling each type of transaction.

1. Receipts from Procurement

Receipts from procurement represent the major FIR accounts utilized to account for material brought into inventory. In essence, they are utilized to account for material that is procured for inventory from outside the Navy Supply System. The FIR codes that represent receipts from procurement are as follows. [Ref. 3: pp. 13 & 57-58]

A1 Receipts from Procurement-Commercial
A3 Receipts from Procurement-other DOD Agencies
A5 Receipts from Procurement-other

The value contained within the A1 FIR account represents total receipts from commercial sources. Receipts from other DOD Agencies procured on a reimbursable basis are accounted for under FIR account A3. FIR account A5 represents the value of material that was either purchased from other governmental agencies, transferred from other stores accounts on a reimbursable basis, or received from internal government manufacturing activities on a reimbursable basis. FIR account A5 is also utilized to account for purchases from foreign governments. The value of these transactions are debited to the appropriate accounts at the purchase price of the material received. When a purchase price is not available, the receipt of material may be debited to inventory at either an estimated price or the standard price. The balances in the Receipt from Procurement Accounts are listed under the Receipts section of the FIR report and are added to Inventory at the end of the accounting period.

Since material is normally carried within the inventory at a standard price, it is necessary to adjust the accounts whenever material is received and debited to the accounts at other than standard price. Standard Cost Variance accounts are used to make these necessary adjustments. These Variance Accounts are:

E1 Financial Adjustments (Gains)-Purchase Variance
N1 Financial Adjustments (Losses)-Purchase Variance

FIR account E1 represents a monetary addition to the inventory valuation and is brought about when the purchase price is less than the standard price. The difference between the purchase price and the standard price is debited to the account which is contained in the Receipts section of the FIR report. FIR Account N1 represents a monetary loss to the value of inventory and as such maintains a credit balance. Usage of the variance is brought about when the purchase price is greater than the standard price. The difference is credited to the account which is included under the Expenditures section of the FIR report. The net impact of posting receipts at purchase price and then debiting or crediting the purchase variance accounts is to create a net addition to the inventory that will be equal to the standard price multiplied by the quantity received.

Each Receipt from Procurement account also has its own Contra-Receipt account that maintains the dollar value of material returns. These accounts are utilized to report the value of material returned by the activity to the original source of procurement for which credit was received by the activity for the value of the material returned. The Contra-Receipt codes are as follows:

- A2 Receipts from Procurement-Material Returns-Commercial
- A4 Receipts from Procurement-Material Returns-other DOD Agencies
- A6 Receipts from Procurement-Material Returns-other

Since material returns represent a decrease in the value of inventory on hand, Contra-Receipt accounts are carried with a credit balance and listed under the Expenditures section of the FIR report. The value of material returned is credited to the Contra-Receipt accounts at standard price since the material is carried in the inventory at standard price after appropriate variance adjustments are made. Figure 2.3 provides a detailed summary of the accounting entries required for Receipts from Procurement.

RECEIPTS		
A1 Receipts from Procurement-Commercial	Purch. Price	
A3 Receipts from Procurement-other DOD Agencies	Purch. Price	
A5 Receipts from Procurement-other	Purch. Price	
PRICE VARIANCE		
E1 Financial Adjustments (Gains) Price Variance	Stan. Price	-Purch. Price
N1 Financial Adjustments (Losses)-Price Variance	Purch. Price	-Stan. Price
RETURNED MATERIAL		
A2 Receipts from Procurement-Returned Material-Commercial	Stan. Price	
A4 Receipts from Procurement-Returned Material-other DOD Agencies	Stan. Price	
A6 Receipts from Procurement-Returned Material-other	Stan. Price	

Figure 2.3 Summary of Receipts from Procurement

2. Transfers from other Supply Officers

Another source of receipts into Inventory results from transfers from other Supply Officers. In essence, these receipts represent receipt of items already contained within the inventory stores account being reported on. Although the value of inventory as contained at the activity level is altered, the overall value of inventory maintained at the central accounting office, in theory, should not change. The accounting for these transfers, then, permits the activity to alter its records and provides the central accounting office with information to be compared and reconciled with reported transfers as discussed in a later section. The FIR codes used for these transfers are as follows: [Ref. 3: p. 35]

F4 Transfers from other Supply Officers-Stock
Transfers

F5 Transfers from other Supply Officers-other

FIR account F4 represents the value of material, within the same inventory account, received from other Supply Officers for inclusion in inventory. Shipping activities should have reported the same dollar value of transfers under FIR account P4 (Transfers to other Supply Officers--Stock Transfers). FIR account F4 is also used by the Aviation Supply Office (ASO) and the Ships Parts Control Center (SPCC) to report the value of material undergoing repair by contractors. Repaired material returned to an activity by a contractor is also reported under FIR account

F4. F5 is utilized to account for the value of material received from other Supply Officers for immediate issue to consumers. The same dollar value should be reported under FIR account P5 (Transfers to other Supply Officers--other) by shipping activities. The value of material transferred, at summarized prices, is debited to the appropriate accounts when Receipt Invoices or other evidence of receipt is obtained by the accounting department. The transfer from other Supply Officers accounts maintain a debit balance and are contained in the Receipt section of the FIR report. Summarized prices are taken from the Summary Invoices of transfers to other Supply Officers provided by the shipping activity and should agree with the value taken up using the Receipt Invoice. The Summary Invoice of transfers is similar in nature to the abstract of Public Vouchers provided by the disbursing activity for Receipts from Procurement.

Since material is carried in inventory and issued or sold at a standard price, there should theoretically be no need to adjust summarized prices unless the transfer occurs during a period of time that standard prices are adjusted or the shipping activity has transferred the material at the wrong price. When these situations arise where such adjustments are required, standard price adjustments are made in order to bring the price of the inventory in line with standard prices. When the summarized price is greater than the

standard price the value of the inventory must be decreased and FIR account N2 (Financial Adjustments (Losses)--Standard Price Adjustments) is credited for the difference between the summarized and standard price. When the reverse occurs and the value of the inventory must be increased, FIR account E2 (Financial Adjustments (Gains)--Standard Price Adjustments) is debited for the difference between the standard and summarized price. Figure 2.4 provides a summary of the accounting entries required for transfers from other Supply Officers.

RECEIPTS		
F4 Transfers from other Supply Officers-Stock Transfers	Summ. Price	
F5 Transfers from other Supply Officers-other	Summ. Price	
PRICE VARIANCE		
E2 Financial Adjustments (Gains) Standard Price Adjustments	Stan. Price	
	-Summ. Price	
N2 Financial Adjustments (Losses)-Standard Price Adjustment	Summ. Price	
	-Stan. Price	

Figure 2.4 Summary of Transfers from Other Supply Officers

3. Receipts from Returned Material

Material is also received into inventory as a result of returned material from user activities. When material is returned to inventory, a decision must be made whether or not

to grant credit to the fund or appropriation of the returning activity, which will have the effect of reducing the monetary account associated with the inventory account material is returned to. Credit to the respective appropriation or stock fund is authorized only for those items approved by the cognizant inventory manager. Generally, credit is authorized for NSA material returned in a ready for issue or repairable condition that is required within the present procurement plan. Material originally issued on a non reimbursable basis from an APA inventory is accepted for a cost credit if returned in a ready for issue or repairable condition. Appropriation or Fund credit is granted when material returned to the APA inventory was originally issued on a reimbursable basis, however, a cost credit may also be granted in this situation depending upon the circumstances surrounding the return. In all cases, material returned in a ready for issue condition will be taken up in the inventory accounts at standard price. Material returned in repairable condition will be taken up at standard price less the cost anticipated for placing the item in a ready for issue condition. The condition of the material returned is indicated on the receipt documentation (usually a transfer document of some sort) that is sent to the accounting department from the stock point.

The procedures used for accounting for material returned to inventory depend upon four distinct factors;

1. whether or not the receiving activity has credit approval authority, 2. the type of inventory account the material is being returned to, 3. the decision concerning the allowance of credit and the type of credit allowed, and 4. the method of original issue. [Ref. 3: pp. 53 & 70-72] Material returned to a receiving activity that does not have credit approval authority and merely holds the material for the inventory manager will be debited to FIR account BB (Receipts without Reimbursement--Suspense Credit Check). BB represents the monetary value of returned material received without credit and awaiting interrogation by the inventory manager. The account maintains a debit balance and is included in the Receipts section of the FIR report. As decisions are made by the inventory manager concerning credit allowance, the FIR accounts permit the recategorization of the material held in inventory. The monetary values are removed from account BB by crediting that FIR account with an offsetting debit to FIR account BC (Receipts without Reimbursement--Suspense Credit Allowed) or FIR account BD (Receipts without Reimbursement--Suspense Credit Denied). The accounting entry appears as follows:

BC Receipts w/o Reimbursement-	Stan. Price
Suspense Credit Allowed	

BD Receipts w/o Reimbursement-	Stan. Price
Suspense Credit Denied	

BB Receipts w/o Reimbursement	Stan. Price
Suspense Credit Check	

FIR accounts BC and BD also carry debit balances and are included in the Receipts section of the FIR report. At the end of the accounting period the combined effect of the three codes permit the receiving activity to analyze the total dollar value of returns awaiting credit decisions, as well as the dollar value of credit decisions made within the period. The above procedures hold true for both types of inventory accounts when material is returned to an activity without credit approval authority. In recent years, FIR accounts BB, BC and BD have fallen into disuse by receiving activities. Instead, the value of returned material is taken up in the accounts of the inventory managers, using the same procedures discussed below. Receiving activities generally monitor the information contained in FIR accounts BB, BC, and BD but do not report the information on the FIR report. This type of situation is referred to as "off ledger" bookkeeping by the accounting community.

Material returned to activities with credit approval authority is accounted for depending upon the type of inventory account involved, the decision concerning the granting of credit to the returning activity, and the method of original issue. Since NSA material is not issued on a non reimbursable basis unless decapitalized from the NSA account, only fund credits are considered for material returned to NSA inventory. Three situations exist for material returned to NSA inventory accounts: 1. credit is

appropriation credit is allowed, 2. cost credit is allowed for material originally issued from stock, 3. appropriation credit is allowed for material originally issued from stock with reimbursement, 4. appropriation credit is allowed for material previously purchased for end use issue, and 5. material was originally issued without statistical costing. When neither cost credit nor appropriation credit is allowed, the value of the material returned will be debited to FIR account B1 (Receipts without Reimbursement--Returns of Material from users) for returns from all Navy, Marine Corps, and other DOD Agencies or FIR account B5 (Receipts without Reimbursement--other) for returns from all other government agencies, foreign governments, and other miscellaneous sources.

A cost credit is credit granted to an activity for statistical purposes only, therefore no adjustment is required to the monetary account associated with the inventory and a credit is granted to a statistical monetary account. Generally, cost credits are granted when the material was originally issued on a non reimbursable basis with statistical costing performed. No adjustment of funds or appropriations is authorized when a cost credit is granted by the inventory manager. When cost credit is authorized for material returned to inventory, the value of the material is taken up in inventory as a debit entry to FIR account K2 (Issues without Reimbursement--Returns--Service

not allowed, 2. credit is allowed for material originally issued under FIR account J1 (Issues with Reimbursement--Service Use) and 3. credit is allowed for material originally issued with reimbursement under FIR accounts other than J1. When credit is not allowed, the value of the returned material will be taken up in inventory by debiting FIR account B1 (Receipts without Reimbursement--Returns of Material from users). The monetary value of returned material originally issued under accounts other than J1 is taken up in inventory by debiting FIR account J4 (Issues without Reimbursements--Returns other than Service Use and MAPS) when appropriation or fund credit is granted. FIR account J4 is a Contra Issue account that serves to offset the amount of issues reported for the value of returned material when credit is allowed. Returned material originally issued under FIR account J1 (Issues with Reimbursement--Service Use) is taken up by debiting the Contra Issue account J2 (Issues with Reimbursement--Returns). The accounting entries utilized for receipt of returned material serve to increase the inventory for the monetary value of the material and identify the credit decision made. The FIR accounts used to adjust the value of inventory maintain debit balances and are reported under the Receipts section of the FIR report.

Five conditions exist for accounting for returned material to APA inventory accounts; 1. neither cost nor

material issued without statistical costing is debited directly to FIR account KE (Issues without Reimbursement--Returns--Service Use). All entries for returned material to APA inventory increase the value of the inventory accounts, identify the credit decision made, and provide offsetting entries to the proper category of issues based on the method of original issue. The accounts will maintain debit balances and are reported under the Receipts section of the FIR report.

It is also possible to grant partial credit for returned material. In this case the value of the credit is accounted for in the same manner as described above. The difference between the standard price and the credit received is taken up in FIR account E3 (Financial Adjustments (Gains--Discount on Material Returns). Figure 2.5 provides a detailed summary of the accounting entries required for Receipts from Returned Material.

4. Receipts without Reimbursement

Receipts without Reimbursement represent the value of material received in inventory for which no charge is made to the stock fund or appropriation funding inventory account purchases. In addition to the accounts that deal directly with material returned to inventory, as discussed earlier, other Receipts without Reimbursement accounts are used within the Financial Inventory Accounting System. The

Use). When material was originally issued from stock with reimbursement and a fund or appropriation credit is granted, the value of the material is taken up in inventory as a debit entry to FIR account J4 (Issues without Reimbursement--Returns--other than Service Use and MAPS). Both accounts K2 and J4 are Contra Issue accounts that serve to offset the values of total issues reported. However, K2 serves to offset issues made with cost charges only while J4 offsets issues made with reimbursement only.

When appropriation credit allowed for material returned to inventory that was originally purchased with charges to an end use functional account, the value of the material, at standard price, will be taken up in inventory as a debit entry to FIR account A5 (Receipt from Procurement--other). When material is originally purchased for end use, it is taken up in the inventory account and immediately issued. The subsequent return of material is therefore not shown as a Contra Issue account but accounted for as a receipt of material.

Material issued under FIR account KD (Issues without Reimbursement--Service Use) represents the value of all APA material issued without statistical costing (i.e. not issued on a cost chargeable basis to an accountable activity). Material of this type returned to inventory can therefore not be considered for cost credit and should not be debited to the inventory account under normal procedures. Returned

RECEIVED BY ACTIVITIES HOLDING MATERIAL BELONGING TO
OTHER ACTIVITIES

RECEIPT

BB Receipts w/o Reimbursement- Suspense Credit Check	Stan. Price
---	-------------

CREDIT DECISION MADE

BC Receipts w/o Reimbursement- Suspense Credit Allowed	Stan. Price
---	-------------

BD Receipts w/o Reimbursement- Suspense Credit Denied	Stan. Price
--	-------------

BB Receipts w/o Reimbursement- Suspense Credit Check	Stan. Price
---	-------------

RECEIVED BY ACTIVITIES OWNING MATERIAL

NSA MATERIAL

CREDIT NOT ALLOWED

B1 Receipts w/o Reimbursement- Return of Material from Users	Stan. Price
---	-------------

CREDIT ALLOWED

ISSUED UNDER FIR CODE OTHER THAN J1

J4 Issues with Reimbursement- Returns-other than Service Use and MAPS	Stan. Price
---	-------------

ISSUED UNDER FIR CODE J1

J2 Issues with Reimbursement- Returns-Service Use	Stan. Price
--	-------------

APA MATERIAL

CREDIT NOT ALLOWED

B1 Receipts w/o Reimbursement- Return of Material from Users	Stan. Price
---	-------------

B5 Receipts w/o Reimbursement- other	Stan. Price
---	-------------

Figure 2.5 Summary of Receipts from Returned Material

CREDIT ALLOWED

COST CREDIT ALLOWED

K2 Issues w/o Reimbursement- Returns-Service Use	Stan. Price
---	--------------------

APPROPRIATION CREDIT ALLOWED

J4 Issues with Reimbursement- Returns-other than Service Use and MAPS	Stan. Price
--	--------------------

ORIGINALLY PURCHASED FOR END USE

A5 Receipts from Procurement- other	Stan. Price
--	--------------------

NO CREDIT DECISION NECESSARY

KE Issues w/o Reimbursement- Returns-Service Use	Stan. Price
---	--------------------

PARTIAL CREDIT ALLOWED

E5 Financial Adjustments (Gains) Discounts on Material Returns	Stan. Price -Credit All.
---	-------------------------------------

Figure 2.5 Contd.

FIR codes used to report Receipts without Reimbursement are as follows: [Ref. 3: pp. 31-32]

- B1 Receipts w/o Reimbursement>Returns of Material
from Users**
- B2 Receipts w/o Reimbursement-Intraservice**
- B3 Receipts w/o Reimbursement-NSA DLR Exchange Program**
- B4 Receipts w/o Reimbursement-Capitalization**
- B5 Receipts w/o Reimbursement-other**
- B9 Receipts w/o Reimbursement-other Retail Activities**

In addition to representing the value of returned material not granted credit, FIR account B1 also includes the value of not ready for issue repairables returned without statistical credit. FIR account B2 represents the value of material transferred from other Navy and Marine

Corps inventory managers except material capitalized into stock fund inventory. It includes transfers into an APA account when material is decapitalized from the stock fund account. FIR account B3 increases the inventory for the difference between the standard price and advanced credits given to users under the NSA DLR Exchange Program. The NSA DLR Exchange Program will be covered in detail in a later section. B4 is used only in conjunction with NSA inventory and represents the value of material taken up in inventory for item management responsibility pursuant to extension or expansion of the stock fund. In addition to its role in accounting for returned material, FIR account B5 includes the value of material received from other government agencies, foreign governments and other miscellaneous sources on a non reimbursable basis. Finally, FIR account B9 represents the value of material received from other retail activities as a result of a change in stocking authority at that activity. With the exception of FIR account B3, all Receipts without Reimbursement are taken up in inventory at standard price. As with all receipts, the accounts maintain debit balances and are included in the Receipts section of the FIR report. Figure 2.6 below is a summary of Receipts without Reimbursement.

B1 Receipts w/o Reimbursement- Return of Material from Users	Stan. Price
---	-------------

Figure 2.6 Summary of Receipts Without Reimbursement

B2 Receipts w/o Reimbursement-Intraservice	Stan. Price
B3 Receipts w/o Reimbursement NSA DLR Exchange Program	Stan. Price -Adv. Credit
B4 Receipts w/o Reimbursement-capitalization	Stan. Price
B5 Receipts w/o Reimbursement-other	Stan. Price
B9 Receipts w/o Reimbursement-other Retail Activities	Stan. Price

Figure 2.6 Contd.

5. Receipts from Property Disposal

The final type of receipts to inventory are Receipts from Property Disposal. Two FIR codes are used to account for Receipts from Property Disposal as follows: [Ref. 3: p. 32]

- C1 From Property Disposal
- C2 From Property Disposal-Reclamation

FIR account C1 represents the value of excess material returned to inventory from property disposal. C2 maintains the value of material returned to inventory after reclamation processing financed by disposal funds. The value of the material received from property disposal is taken up in inventory by debiting the accounts at standard price. Similar to all Receipts, Receipts from Property Disposal maintain a debit balance and are reported under the Receipts section of the FIR report.

F. EXPENDITURES

1. Issues with Reimbursement

Issues with Reimbursement represent the major means of expending material from inventory. In general, Issues

with Reimbursement are used to account for the expenditure of material when the value of the stock fund or appropriation dollar balances are increased as a result of the issue. The FIR codes utilized for accounting for Issues with Reimbursement are as follows: [Ref. 3: p. 33]

- J1 Issues with Reimbursement-Service Use
- J3 Issues with Reimbursement-other than Service Use and MAPS
- J5 Issues with Reimbursement-MAPS

FIR account J1 is used to maintain the monetary value of material issued with direct charge to Navy or Marine Corps appropriations, as well as material issued with direct charges to DOD appropriations held by Navy activities. J1 is utilized only to account for issues from NSA inventory accounts. FIR account J3 represents the value of material issued as cash sales to Navy and Marine Corps appropriations, other DOD agencies, government departments, private parties, non-appropriated fund activities, and foreign governments. This FIR account is the major account utilized in conjunction with APA inventory for all Issues with Reimbursement both internal and external to the Navy. The NSA inventory account only uses FIR account J3 when Issues with Reimbursements are made external to the Naval service. J5 is a special FIR account that represents the amount of material issued under the Military Assistance Grant Aid program or sold to foreign governments under the Military Assistance Sales program Cooperative Logistics

Sales-Arrangements. The account is only to be utilized by NAVILCO, Philadelphia, who take receipt of the material prior to its issue or sale. Since all sales and issues are made at standard price, Issues with Reimbursement are expended from inventory by crediting the appropriate account at that price. The issue accounts will maintain credit balances and are included in the Expenditures section of the FIR report.

Two Contra Issue accounts exist in order to maintain net total issues in an up to date status as previously discussed. The Contra Issues with Reimbursement accounts are as follows:

- J2 Issues with Reimbursement>Returns-Service Use
- J4 Issues with Reimbursement>Returns-other than
Service Use and MAPS

FIR account J2 represents material returned to inventory that was originally issued under FIR account J1, while J4 represents material originally issued under FIR account J3. No accounting procedures are established for returned material originally issued under FIR account J5 due to the special nature of the issue. The Contra Issue accounts are taken up in inventory at standard price with debit entries and serve to offset the total value of Issues with Reimbursements, thus providing an accurate accounting of "NET" issues. They maintain a debit balance and are included in the Receipts section of the FIR report. Figure 2.7 below is a summary of Issues with Reimbursement.

ISSUES		
J1	Issues with Reimbursement- Service Use	Stan. Price
J3	Issues with Reimbursement- Service Use and MAPS	Stan. Price
J5	Issues with Reimbursement- MAPS	Stan. Price
RETURNED MATERIAL		
J2	Issues with Reimbursement- Returns-Service Use	Stan. Price
J4	Issues with Reimbursement- Returns other than Service Use and MAPS	Stan. Price

Figure 2.7 Summary of Issues with Reimbursement

2. Issues without Reimbursement

Issues without Reimbursement represent the value of material issued from inventory without a corresponding reimbursement to the stock fund or appropriation responsible for maintaining the inventory. In general, Issues without Reimbursement are statistically charged to a job order or appropriation without the corresponding transfer of funds. However, procedures do exist for accounting for issues made without reimbursement where statistical costing is not performed. The FIR codes used to account for Issues without Reimbursement are as follows: [Ref. 3: p. 34]

- K1 Issues without Reimbursement-Service Use
- K3 Issues without Reimbursement-Intraservice
- K5 Issues without Reimbursement-Decapitalization
- K6 Issues without Reimbursement-MAP-Grant Aid
- K7 Issues without Reimbursement-Material Returns
- K8 Issues without Reimbursement-other

K9 Issues without Reimbursement-other Retail
Activities
KB Issues without Reimbursement-Retail to
Wholesale Activity
KD Issues without Reimbursement-Service Use

FIR account K1 represents the monetary value of material issued to Navy and Marine Corps activities with statistical cost charges only. It is only utilized in conjunction with APA inventory. NSA material is not issued on a non reimbursable basis unless it is being decapitalized from inventory. K3 maintains the value of material transferred to another activity as a result of changes in cognizance authority except when material is decapitalized from NSA inventory. FIR account K5 decreases the inventory for the monetary value of material transferred to another activity as a result of a change in inventory management responsibility out of NSA inventory accounts. K6 represents the value of material issued under the MAPS program in a non reimbursable manner. FIR account K7 is utilized to report the value of material returned to the Defense Stock Fund for which credit is not allowed. Expenditures from material returned from inventory will be covered in greater detail in a later section. FIR account K8 represents the value of material issued on a non reimbursable basis to other DOD agencies, government departments, states, local governments and other organizations approved by DOD. The account also includes the value of excess material issued to another retail activity. K9 accounts for the value of material

transferred to other retail activities as a result of changes in stocking authorization at the transferring activity. KB is a special account that represents issues of clothing to prisoners of other services. Finally, FIR account KD represents the issues to other Navy and Marine Corps Activities when statistical costing is not performed. It is similar to account K1 and its use results from the same set of circumstances, however, it is only utilized when statistical costing is not performed.

Issues without Reimbursement are also expended from inventory at standard price by crediting the appropriate account. In all cases, except account KD, an offsetting statistical cost charge or appropriation charge will be debited to an account maintained for the inventory account under consideration by the FPIC. Special appropriation type data are established by NAVCOMPT to account for the value of material issued under account KD. Issues without Reimbursement maintain a credit balance and are reported under the Expenditures section of the FIR report.

Because of the nature of most issues without reimbursement (i.e. transfers, returns, Grant aids, and sales on a non reimbursable basis), procedures have been established to account for returned material issued without reimbursement for service use only. Therefore, the only two accounts established for returned material are as follows:

K2 Issues without Reimbursement-Returns
Service Use

KE Issues without Reimbursement>Returns Service Use

FIR account K2 is used when returned material was originally issued under FIR account K1, while KE is used when material was originally issued under FIR account KD. The value of the returned material is taken up in inventory by debiting the appropriate accounts, which are contained in the Receipts section of the FIR report. Figure 2.8 is a summary of the accounting entries required for Issues without Reimbursement.

ISSUES		
K1 Issues w/o Reimbursement- Service Use		Stan. Price
K3 Issues w/o Reimbursement- Intraservice		Stan. Price
K5 Issues w/o Reimbursement- Decapitalization		Stan. Price
K6 Issues w/o Reimbursement- MAPS-Grant aid		Stan. Price
K7 Issues w/o Reimbursement- Material Returns		Stan. Price
K8 Issues w/o Reimbursement- other		Stan. Price
K9 Issues w/o Reimbursement- other Retail Activities		Stan. Price
KB Issues w/o Reimbursement- Retail to Wholesale		Stan. Price
KD Issues w/o Reimbursement- Service Use		Stan. Price
MATERIAL RETURNS		
K2 Issues w/o Reimbursement- Returns-Service Use	Stan. Price	
KE Issues w/o Reimbursement- Returns-Service Use	Stan. Price	

Figure 2.8 Summary of Issues without Reimbursement

3. Transfers to other Supply Officers

Transfers to other Supply Officers represent a major portion of the monetary value of expenditures from inventory at most activities. The FIR codes utilized to account for transfers to other Supply Officers are as follows:

[Ref. 3: p. 35]

P4 Transfers to other Supply Officers-Stock Transfers
P5 Transfers to other Supply Officers-other

FIR account P4 represents the value of material transferred to other Supply Officers for stock within the same inventory account. Receiving activities should have reported the same dollar value of transfers under FIR account F4 (Receipts from other Supply Officers--Stock Transfers). Activities shipping material to contractors for repair will also report the issue under FIR account P4, which will be taken up by the Aviation Supply Office (ASO) and the Ships Parts Control Center (SPCC) under FIR account F4. When material is returned to the shipping activity by the contractor, ASO or SPCC will expend the material from their records under FIR account P4 and the value of the repaired material will be taken up by the activity in FIR account F4. FIR account F5 is utilized to report the value of material shipped to other Supply Officers for immediate issue. As before, the receiving activity should have reported the same dollar value of transfers under FIR account F5 (Receipts from other Supply Officers--other).

Transfers to other Supply Officers are reported by the shipping activity on NAVCOMPT 177 (Summary of Invoices Covering Transfers between Supply Officers) within 30 days from the actual transfer of material. These summary invoices are used by the receiving activity in accounting for and reconciling their receipts from transfers from other Supply Officers as discussed in a later section. Material is expended from inventory at the summarized price contained on the NAVCOMPT 177 and should be in agreement with the standard price maintained by the shipping activity. Similar to all expenditures from inventory, transfers to other Supply Officers maintain credit balances and are included in the Expenditures section of the FIR report.

4. Expenditures as a Result of Returned Material

Another means of expending material from inventory is to return material to the original issuing or selling activity. The procedures and accounts utilized for expending material returned depends upon; 1. the original issuing activity, 2. the credit decision made by the inventory manager, and 3. the timing of the material return. [Ref. 3, pp. 70-71] In general, material returned for credit is accounted for with a credit entry to a Contra Receipt account, which serves to offset the original receipt for the monetary value of the returned material. Material returned without credit is accounted for as an Issue without Reimbursement or as an Inventory Adjustment depending upon

the timing of the return. Material returned with credit will be expended from inventory by crediting one of the Contra Receipt accounts listed below, dependent upon the original source of acquisition.

- A2 Receipts from Procurement-Material Returns
Commercial
- A4 Receipts from Procurement-Material Returns
other DOD Agencies
- A6 Receipts from Procurement-Material Returns
other

The procedures discussed below pertain only to material originally obtained from other DOD agencies, GSA, and other government agencies; since return of material to commercial sources is always accompanied by a credit allowance. When credit is not allowed by the inventory manager, the accounting procedures utilized to expend the value of the material from inventory are dependent solely upon the time material is returned. Material can be returned by an activity at two different times; 1. material carried in the inventory can be returned with a credit request depending upon its present condition, or 2. material received in shipment can be found to be defective and returned to the shipping activity. When material is returned from inventory and credit is not authorized material originally received into FIR account A3 (Receipts from Procurement--other DOD agencies) is expended from inventory through FIR account K7 (Issues without Reimbursement--Material returns). Material originally received into FIR account A5 (Receipts from Procurement--other)

will be expended from inventory with a credit entry to FIR account K8 (Issues without Reimbursement--other).

When material is returned as a result of discrepancies in shipment, it is assumed that credit will be granted and the value of the material is credited to contra receipt Accounts A4 or A6 depending upon the means of original receipt. When a subsequent disapproval of credit is processed by the inventory manager, it becomes necessary to reverse the original entry and account for the expenditure of material in some other manner. The value of material originally credited to accounts A4 and A6 will be reversed with a debit entry. An offsetting credit entry will be made to FIR account K7 (Issues without Reimbursement--Material Returns), if material was originally returned to a Defense Stock Fund or other wholesale stock fund, or FIR account M6 (Inventory Adjustments (Losses)--Shrinkage, Theft, etc.) in all other cases. If partial credit is granted by the inventory manager, a reversing debit entry will be made to the appropriate Contra Receipt account with an offsetting credit to FIR account N3 (Financial Adjustments (Losses)--Discounts on Material Returns) for the difference between the original entry and the amount of credit granted. All material returns are expended by crediting the respective accounts at standard price. The material returns accounts are included in the Expenditures section of the FIR report. Figure 2.9

provides a detailed summary of Expenditures as a result of returned material.

CREDIT ALLOWED

A2 Receipts from Procurement Material Returns-Commercial	Stan. Price
A4 Receipts from Procurement Material Returns-other DOD Agencies	Stan. Price
A6 Receipts from Procurement- Material Returns-other	Stan. Price

MATERIAL RETURNED FROM INVENTORY, CREDIT NOT ALLOWED

Material originally Received in Account A3

K7 Issues w/o Reimbursement- Material Returns	Stan. Price
--	-------------

Material originally Received in Account A5

K8 Issues w/o Reimbursement- other	Stan. Price
---------------------------------------	-------------

DISCREPANT MATERIAL RECEIVED IN SHIPMENT RETURNED

Original Entry

A4 Receipts from Procurement Material Returns-other DOD Agencies	Stan. Price
A6 Receipts from Procurement Material Returns-other	Stan. Price

Credit Disallowed

A4 Receipts from Procurement Material Returns-other DOD Agencies	Stan. Price
A6 Receipts from Procurement Material Returns-other	Stan. Price
K7 Issues w/o Reimbursement Material Returns	Stan. Price
M6 Inventory Adjustments (Losses) shrinkage, theft, etc.	Stan. Price

Figure 2.9 Summary of Expenditures from Returned Material

Partial Credit Allowed

A4 Receipts from Procurement	Stan. Price
Material Returns-other DOD Agencies	-Cred. All.

A6 Receipts from Procurement	Stan. Price
Material Returns-other	-Cred. All.

N3 Financial Adjustments	Stan. Price
(Losses) Discounts on Material Returns	-Cred. All.

Credit Allowed

No entry required

Figure 2.9 Contd.

5. Transfers to Property Disposal

Finally, material may be expended from inventory as a transfer to property disposal. Two FIR codes are utilized to account for these transfers. [Ref. 3: p. 34]

L1 Transfers to property disposal
L2 Transfers to property disposal-reclamation

The value of material contained in FIR account L1 represents excess material turned in to property disposal. FIR account L2 maintains the value of material transferred to a reclamation activity for processing when disposal funds are to be utilized for reclamation. The value of material transferred to property disposal is expended from inventory at standard price. Similar to all expenditures, transfers to property disposal will be accounted for by credit entries to the appropriate accounts, which will be included in the Expenditures section of the FIR report.

G. RECATEGORIZATION/REVALUATION/PHYSICAL ADJUSTMENTS

1. Inventory Adjustments

Inventory adjustments are utilized to alter the value of inventory as a result of changes in the quantity of material actually on hand or to recategorize the classification of the material (i.e. a change in condition code or material control code). Adjustments that represent gains to inventory are taken up with a debit entry to the appropriate adjustment account, which is in turn included in the Receipts section of the FIR report. The FIR codes utilized to account for inventory adjustment gains are as follows:

[Ref. 3: p. 32]

- D1 Inventory Adjustments (Gains)-Condition Transfers
- D2 Inventory Adjustments (Gains)-Material Control Code Transfers
- D3 Receipts w/o Reimbursements-SERVMART material
- D4 Inventory Adjustments (Gains)-Physical Inventory
- D5 Inventory Adjustments (Gains)-Incoming Shipments
- D6 Inventory Adjustments (Gains)-NSA DLR Exchange Program
- D7 Inventory Adjustments (Gains)-Returns from Cognizance Symbol 1Q
- D8 Inventory Adjustments (Gains)-Transfer of Clothing from Navy Exchange

In contrast, adjustments that represent losses to inventory are expended with a credit entry to the appropriate adjustment account, which is in turn included in the Expenditures section of the FIR report. The FIR codes that are utilized for inventory adjustment losses are as follows: [Ref. 3: pp. 34-35]

- M1 Inventory Adjustments (Losses)-Condition Transfers
- M2 Inventory Adjustments (Losses)-Material Control Code Transfers

- M3 Issues w/o Reimbursement-SERVMART Material
- M4 Inventory Adjustments (Losses)-Physical Inventory
- M5 Inventory Adjustments (Losses)-Incoming Shipment
- M6 Inventory Adjustments (Losses)-Shrinkage, Theft, etc.
- M7 Inventory Adjustments (Losses)-Major Disaster Losses
- M8 Inventory Adjustments (Losses)-NSA DLR
Exchange Program
- MA Inventory Adjustments (Reductions)-Transfers to
Cognizance Symbol 1Q
- MB Inventory Adjustments (Reductions)-Transfer of
Clothing to Navy Exchange

It is readily apparent that many gain and loss adjustment transactions are similar in nature and occur under the same set of circumstances. As discussed earlier, the inventory accounts are maintained for each combination of Condition code and Material Control Code within each cognizance symbol contained in each type of inventory account. It is, therefore, necessary to be able to account for transfers between condition codes and material control codes in order to maintain the proper level of detail required. FIR accounts D1 (Inventory Adjustments (Gains)--Condition Transfers) and M1 (Inventory Adjustments (Losses)--Condition Transfers) are utilized to adjust the accounts for the monetary value, at standard price, taken up or expended from inventory as a result of condition transfers. FIR accounts D2 (Inventory Adjustments (Gains)--Material Control Code Transfers) and M2 (Inventory Adjustments (Losses)--Material Control Code Transfers) act to adjust the value of the accounts, at standard price, for transfers between material control codes. The same value recorded as a gain to one account is reported as a loss to a similar account.

The overall effect of the adjustments will not alter the value of inventory maintained at the cognizance symbol level but merely recategorizes the value of inventory maintained at the level at which the accounts are maintained.

In contrast to the above adjustments, the remaining accounts discussed below have the same effect on all levels of inventory maintenance. FIR accounts D3 (Receipts w/o Reimbursement--SERVMART Material) and M3 (Issues w/o Reimbursement--SERVMART Material) deal with the value of inventory that the activity is responsible for, but held as SERVMART vice Main Store material. D3 represents the net value of material transferred to SERVMART while M3 represents the net value of material issued to SERVMART by the Main Store. The adjustments serve simply to identify the value of material held by SERVMARTS and do not alter the total value of inventory. As material is received by SERVMART the value of material is debited to FIR account D3 (Receipts w/o Reimbursement--SERVMART Material) with an offsetting credit entry to FIR account M3 (Issues w/o Reimbursement--SERVMART Material). Since the accounts are net adjustment accounts, then the value of material returned will be accounted for with the same entry in reverse order. In essence, SERVMART material is second echelon of supply material in the same manner as the ready supply stores and other special accounting classes discussed previously. However, the activity maintains accountability for the

material and therefore reports its value with the main store vice separately. For this reason, it is considered necessary to have some means to identify the material that is held at this particular second echelon level. The entries required to account for SERVMART material appear as follows:

ISSUE TO SERVMART

D3 Receipts w/o Reimbursement SERVMART Material	Stan. Price
--	-------------

M3 Issues w/o Reimbursement SERVMART Material	Stan. Price
--	-------------

RETURN TO MAIN STORE

M3 Issues w/o Reimbursement SERVMART Material	Stan. Price
--	-------------

D3 Receipts w/o Reimbursement SERVMART Material	Stan. Price
--	-------------

In addition to affecting all inventory levels in the same manner, the remaining inventory adjustments also directly affect the total value of inventory. FIR account D4 (Inventory Adjustments (Gains) Physical Inventory) and M4 (Inventory Adjustments (Losses) Physical Inventory) represent the monetary value of adjustments necessary to bring the stock records into agreement with the actual count of material on hand. FIR accounts D5 (Inventory Adjustments (Gains)--Incoming Shipments) and M5 (Inventory Adjustments (Losses)--Income Shipments) are utilized to adjust the inventory for the value of shipment discrepancies in accordance with the procedures discussed in a later section. FIR account D6 (Inventory Adjustment (Gains)--NSA DLR Exchange

Program) and M8 (Inventory Adjustment (Losses)--NSA DLR Exchange Program) are special adjustment accounts utilized under the NSA DLR Exchange Program and will be discussed in more detail in a later section.

Transfers of material within the supply system are accounted for as receipts or expenditures as described in the various sections discussed to this point. In contrast, transfers to and Receipts from activities under the Navy Resale System are accounted for as inventory adjustments. FIR accounts D7 (Inventory Adjustment (Gains)--Returns from Cognizance Symbol 1Q) and MA (Inventory Adjustment (Losses)--Transfers to Cognizance symbol 1Q) represent the value of material, at standard price, received from or transferred to inventory accounts financed by non-appropriated ships store or commissary store funding. FIR accounts D8 (Inventory Adjustments (Gains)--Transfer of Clothing from Navy Exchanges) and MB (Inventory Adjustments (Losses)--Transfer of clothing to Navy Exchanges) are utilized when accounting for transfers of stock with non-appropriated Navy Exchange Inventories.

Two separate accounts are utilized to account for the loss of material when such a loss can be recognized at the time of its occurrence, or at some time prior to a physical inventory. In addition to the usages described previously, FIR account M6 Inventory Adjustments (Losses)--Shrinkage, Theft, etc.) is utilized to expend from inventory

the value of material surveyed as a result of shrinkage, fire, theft, deterioration, testing, inspection, sampling, vandalism, freezing, latent defects, evaporation, and any other reductions not specifically covered by another FIR coded account. FIR account M7 represents the value of material expended from inventory as a result of a major fire, earthquake, flood, enemy action, or Act of God for which compensation is not received.

2. Financial Adjustments

Whereas inventory adjustments are utilized to account for changes in quantity, financial adjustments account for changes in the value of material maintained or received in inventory. Adjustments that represent gains to inventory are taken up with a debit entry to the appropriate adjustment account, which is in turn included in the Receipts section of the FIR report. The FIR codes that are utilized to account for financial adjustment gains are as follows: [Ref. 3: pp. 32-33]

- E1 Financial Adjustments (Gains)-Purchase Variance
- E2 Financial Adjustments (Gains)-Standard Price Adjustments
- E3 Financial Adjustments (Gains)-Discount on Material Returns
- E4 Financial Adjustments (Gains)-Accounting Adjustments
- E5 Financial Adjustments (Gains)-Assembly/Disassembly
- E8 Financial Adjustments (Gains)-Returns of Advanced Credit Material under NSA DLR Exchange Program
- E9 Financial Adjustments (Gains)-Nonreturn of Advanced Credit Material under NSA DLR Exchange Program

On the other hand, adjustments that represent losses to inventory are expended with a credit entry to the appropriate

adjustment account, which is in turn included in the Expenditures section of the FIR report. The FIR codes utilized to account for financial adjustment losses are as follows: [Ref. 3: p. 35]

- N1 Financial Adjustments (Losses)--Purchase Variance
- N2 Financial Adjustments (Losses)--Standard Price Adjustment
- N3 Financial Adjustments (Losses)--Discounts on Material Returns
- N4 Financial Adjustments (Losses)--Accounting Adjustments
- N5 Financial Adjustments (Losses)--Assembly/Disassembly
- N6 Financial Adjustments (Losses)--FMS Price Reductions
- N8 Financial Adjustments (Losses)--Advance Credits given on Issues with Reimbursement under NSA DLR Exchange Program

The receipts section discussed the role of FIR accounts E1 (Financial Adjustment (Gains)--Purchase Variance), N1 (Financial Adjustments (Losses)--Purchase Variance), E2 (Financial Adjustments (Gains)--Standard Price Adjustment), and N2 (Financial Adjustment (Losses)--Standard Price Adjustment) when accounting for material received at a price other than the standard price. In addition, the standard price adjustment accounts are utilized to adjust the value of inventory when the price that material is carried in inventory is in disagreement with standard price. This adjustment most commonly occurs when a new standard price is established and the value of the material in inventory must be adjusted to conform accordingly.

FIR accounts E3 (Financial Adjustments (Gains)--Discount on Material Returns) and N3 (Financial Adjustments

(Losses)--Discount on Material Returns) are utilized in conjunction with the return of material from or to inventory when only partial credit is granted by the inventory manager. FIR account E3 represents the difference between the standard price of material taken up in inventory and the amount of credit allowed, while N3 represents the difference between the standard price of material expended from inventory and the amount of credit granted. FIR accounts E4 (Financial Adjustments (Gains)--Accounting Adjustments) and N4 (Financial Adjustments (Losses)--Accounting Adjustments) are utilized to adjust the inventory for differences between the total extended value of material contained in the stock record system and the value of material as maintained in inventory as per the Financial Inventory Accounting System. The size of the accounting adjustments required, as discovered during the reconciliation process, is an indication of how closely the two systems are tracking on the same inventory and is a good indicator of the effectiveness of the Financial Inventory Accounting System. The reconciliation process between the two systems will be discussed further in a later section. FIR accounts E5 (Financial Adjustments (Gains)--Assembly/Disassembly) and N5 (Financial Adjustments (Losses)--Assembly/Disassembly) adjust the value of inventory for gains or losses realized as a result of assembly, disassembly, fabrication, modification, repair, overhaul, testing, conversion, or other

processing. The gain reflects the value of material that is returned to inventory on hand from processing. The loss reflects the transfer of material from inventory to processing. FIR account N6 (Financial Adjustments (Losses)--FMS price Reductions) represents the difference between standard price and the sales price of material sold to foreign governments at less than standard price. Finally, FIR accounts E8 (Financial Adjustments (Gains)--Returns of Advanced Credit Material under NSA DLR Exchange Program), E9 (Financial Adjustments (Gains)--Nonreturn of Advanced Credit Material under NSA DLR Exchange Program) and N8 (Financial Adjustments (Losses)--Advance Credits given on Issue with Reimbursement under NSA DLR Exchange Program) are special accounts utilized in conjunction with the NSA DLR program and are discussed in the following section.

H. SPECIAL CATEGORIES

1. Discrepancies in Shipment

In addition to the procedures for accounting for material receipts, expenditures, recategorizations, revaluations, and physical adjustments, the Financial Inventory Accounting System contains other special procedures for making adjustments to inventory totals. Probably the most complex of these procedures is the detailed adjustment entries required to account for discrepancies in shipments. The adjustment entries required to account for these discrepancies are dependent upon; 1. the original source of

the Receipt, 2. the type of shipment and the source of liability for the shipment, and 3. the total dollar value of the discrepancy. [Ref. 3: pp. 51-56] The procedures contained in this section apply to receiving activities only. It is assumed that the shipping activity will account for material actually shipped in a proper manner. Adjustments for discrepancies in shipment are usually not found by shipping activities and eventually become physical inventory adjustments at the end of the accounting period. Distinctions are made when accounting for discrepancies in shipments according to three different original sources of receipt;

1. shipment received directly from a manufacturer or vendor,
2. shipments from Navy or Marine Corps stock points, and
3. shipments from Army, Air Force, DLA, or GSA stock points.

When material is received from a manufacturer or vendor, the entire dollar value of the Receipt document is taken up in FIR account A1 (Receipts from Procurement--Commercial). Regardless of the type of shipment, material discrepancies of \$25 or less are expended through FIR account M5 (Inventory Adjustments (Losses)--Incoming Shipments). If material discrepancies in excess of \$25 exist, then standard form 364 (Report of Item Discrepancy Report) will be prepared. The dollar value of the discrepancy is expended from inventory as a credit entry to receipt account A1. Overages from commercial sources, which are deemed acceptable by the receiving activity, are taken up in inventory

with a debit entry to FIR account D5 (Inventory Adjustments (Gains)--Incoming Shipments). Unacceptable overages will be returned for credit using the procedures discussed earlier.

The entire dollar value of the receipt documentation for shipments with discrepancies received from other Navy and Marine Corps stock points will be taken up in inventory to FIR account A5 (Receipts from Procurement--other) for purchased material or FIR account F4 (Transfers from other Supply Officers--Stock Transfers) for material transfers. When material is shipped via parcel post, government carrier, or commercial ocean carrier and the liability for the material rests with those carriers, the entire value of the discrepancy is expended from inventory through FIR account M5 (Inventory Adjustments (Losses)--Incoming Shipments). If liability for the material is upon a commercial carrier, then the value of discrepancies in shipment are expended utilizing account J3 (Issues with Reimbursements--other than Service use and MAPS) for discrepancies in excess of \$250. A debit entry is made to the appropriation or fund account for the reimbursement received from the carrier by the FIPC. Discrepancies of less than \$250 are expended through FIR account M5 (Inventory Adjustments (Losses)--Incoming Shipment). When liability remains with the shipping activity and a discrepancy greater than \$250 results, then the monetary value of the discrepancy is

expended from inventory under FIR account A5 (Receipts from Procurement--other), if material was originally purchased by the receiving activity. If discrepancies are less than \$250 or if material is acquired on a non reimbursable basis, the value of the discrepancy is expended from inventory utilizing FIR account M5 (Inventory Adjustments (Losses)--Incoming Shipments). Overages may either be taken up in inventory utilizing FIR account D5 (Inventory Adjustments (Gains)--Incoming Shipments) or returned to the issuing activity under the procedures discussed earlier.

The accounting entries utilized to process discrepancies in shipment from Army, Air Force, DLA, or GSA stock points are in most cases identical to the procedures for discrepancies from Navy and Marine Corps stock points. The following exceptions are noted: 1. Material is taken up in inventory under FIR account A3 (Receipts from Procurement--other DOD agencies) with the exception of GSA material which will continue to be taken up in account A5. 2. When the liability for material is upon a commercial carrier, then the value of discrepancies will be expended from inventory by a credit entry to FIR account A3 (Receipts from Procurement--other DOD Agencies). 3. If the liability remains with the shipping activity and a discrepancy with a value greater than \$250 occurs, then the value of the discrepancy will be expended by crediting FIR account A3 (Receipts from Procurement--other), when the shipping activity was an Army, Air

Force, or DLA stock point. FIR account A5 (Receipts from Procurement--other) will continue to be utilized when the shipping activity was a GSA stock point. 4. FIR account M6 (Inventory Adjustments (Losses)--Shrinkage, Theft, etc.) will be utilized to expend from inventory the value of discrepancies in shipments, regardless of the dollar value, when material shipped under this category is classified as sensitive, drug abuse controlled, or pilferable. Figure 2.10 provides a detailed summary of the entries required to account for discrepancies in shipments.

MATERIAL SHIPPED FROM COMMERCIAL SOURCE		
Receipt		
A1 Receipts from Procurement Commercial	I.R. Value	
Shortages		
less than \$25		
M5 Inventory Adjustments (Losses)-Incoming Shipment	Value of Discrepancy	
greater than \$25		
A5 Receipts from Procurement-Commercial		
Overages Accepted		
D5 Inventory Adjustments (Gains)-Incoming Shipment	Value of Discrepancy	
MATERIAL SHIPPED FROM OTHER NAVY AND MARINE CORPS STOCK POINTS		
Receipt		
A5 Receipts from Procurement- other	I.R. Value	

Figure 2.10 Summary of Discrepancy in Shipment Adjustments

F4 Transfers from other Supply Officers-Stock Transfers	I.R. Value
Shortages	
Parcel Post, Government, Commercial Ocean Carriers	
M5 Inventory Adjustments (Losses)-Incoming Shipment	Value of Discrepancy
Commercial Carrier Liability	
less than \$250	
M5 Inventory Adjustments (Losses)-Incoming Shipment	Value of Discrepancy
greater than \$250	
J3 Issues with Reimbursement other than Service Use and MAPS	Value of Discrepancy
Shipping Activity Liability	
Purchased Material	
less than \$250	
M5 Inventory Adjustments (Losses)-Incoming Shipment	Value of Discrepancy
greater than \$250	
A5 Receipts from Procurement other	Value of Discrepancy
Received on non reimbursable basis	
M5 Inventory Adjustments (Losses)-Incoming Shipment	Value of Discrepancy
Overages, accepted	
D5 Inventory Adjustments (Gains)-Incoming Shipment	Value of Discrepancy
MATERIAL SHIPPED FROM ARMY, AIR FORCE, DLA, OR GSA STOCK POINTS	
Receipt	
A3 Receipts from Procurement other DOD Agencies	I.R. Value
A5 Receipts from Procurement other	I.R. Value

Figure 2.10 Contd.

Shortages		
Parcel Post, Government, Commercial Ocean Carrier		
M5 Inventory Adjustments		Value of
(Losses)-Incoming Shipment		Discrepancy
Commercial Carrier Liability		
less than \$250		
M5 Inventory Adjustments		Value of
(Losses)-Incoming Shipment		Discrepancy
greater than \$250		
A3 Receipts from Procurement		Value of
other DOD Agencies		Discrepancy
Shipping Activity Liability		
less than \$250		
M5 Inventory Adjustments		Value of
(Losses)-Incoming Shipment		Discrepancy
greater than \$250		
A3 Receipts from Procurement		Value of
other DOD Agencies		Discrepancy
A5 Receipts from Procurement		Value of
other		Discrepancy
Sensitive, Drug Abuse Controlled, and Pilferable Material		
M6 Inventory Adjustments		Value of
(Losses) Shrinkage, Theft, etc.		Discrepancy
Overages		
D5 Inventory Adjustments	Value of	
(Gains)-Incoming Shipment	Discrepancy	

Figure 2.10 Contd.

2. NSA DLR Exchange Program Accounting Procedures

Special accounting procedures are utilized when accounting for depot level repairable (DLR) material within the NSA Inventory account. DLR material is essentially high value material that is repaired at the depot level and

returned to inventory. When DLR material is issued to a customer activity, issues are made with the understanding that the receiving activity will return a repairable carcass on a one for one basis. Upon issue, advanced credit is granted to the receiving activity in anticipation of the subsequent receipt of a repairable carcass. The value of the advanced credit is expended from inventory by crediting FIR account N8 (Financial Adjustments (Losses)--Advanced credits given on Issues with Reimbursements under NSA DLR Exchange Program). No charge is made to the Appropriation or fund of the receiving activity for this portion of the issue price. The noncreditable portion of the issue is expended from inventory through FIR account J1 (Issues with Reimbursement--Service Use). The effect of the two is to expend the entire standard price of the material from inventory. Upon receipt of the repairable carcass, the portion of the standard price of the material originally given advanced credit is taken up in inventory under FIR account E8 (Financial Adjustments (Gains)--Returns of Advance Credit Material under NSA DLR Exchange Program), and the non creditable portion is taken up under FIR account B3 (Receipts without Reimbursement--NSA DLR Exchange Program). [Ref. 3: pp. 32-35]

When repairable carcasses are not received by the issuing activity, adjustments to the inventory accounts are required in order to correctly reflect the status of the

advanced credits granted. The overall effect of these entries will not alter the total value of inventory on hand since no change has taken place to the actual quantity of stock on hand. When the repairable carcass is, in fact, not shipped by the customer activity, then a debit entry is made to FIR account E9 (Financial Adjustments (Gains)--Nonreturn of Advanced Credit Material under NSA DLR Exchange Program) with an offsetting credit entry to FIR account J1 (Issues with Reimbursement--Service use). The credit entry to J1 identifies the monetary value of charges to be made to the appropriation of the customer activity as a consequence of non shipment. When the repairable carcass is not received by the issuing activity but was, in fact, shipped by the receiving activity then a debit entry will be made to FIR account D6 (Inventory Adjustments (Gains)--NSA DLR Exchange Program) with an offsetting credit entry to FIR account M8 (Inventory Adjustments (Losses)--NSA DLR Exchange Program). The credit entry serves to recognize a loss to the NSA account for the value of the advanced credit without a corresponding charge to the appropriation of the receiving activity. The debit entries to accounts D6 and E9 serve to offset the value of advanced credit material remaining outstanding and permit analysis of the percentage of material not received after advanced credit had been granted. Figure 2.11 provides a detailed summary of the

entries required to account for transactions under NSA DLR Exchange Program.

Issuing of Material and Granting of Advanced Credit		
N8 Financial Adjustments (Losses) Advance Credits given on Issues with Reimbursement under the NSA DLR Exchange Program		Adv. Credit
J1 Issues with Reimbursement Service Use		Stan. Price -Adv. Credit
Receipt of Repairable Carcass		
B3 Receipts w/o Reimbursement NSA DLR Exchange Program	Stan. Price -Adv. Credit	
E8 Financial Adjustments (Gains) Return of Advance Credit Material under NSA DLR Exchange Program	Adv. Credit	
Advanced Credit Material Shipped, Not Received		
D6 Inventory Adjustments (Gains)-NSA DLR Exchange Program	Adv. Credit	
M8 Inventory Adjustments (Losses)-NSA DLR Exchange Program	Adv. Credit	
Advanced Credit Material Not Shipped		
E9 Financial Adjustments (Gains) Nonreturn of Advance Credit Material under NSA DLR Exchange Program	Adv. Credit	
J1 Issues with Reimbursement Service Use	Adv. Credit	

Figure 2.11 Summary of Transactions under NSA DLR Exchange Program

I. CLOSING INVENTORY

The value of material in the closing inventory is maintained in the financial accounting records in FIR account R1 (Closing Inventory). The balance contained in R1 should equal the value of the opening inventory plus all receipts, less all expenditures. The closing inventory account will serve as the beginning inventory for the subsequent period. [Ref. 3: p. 36]

J. RECONCILIATION OF FIR INFORMATION AND STOCK RECORD DATA .

At the end of each accounting period the total value of inventory in the Financial Inventory Accounts is compared with the value of inventory contained on the stock records. The purpose of this matching procedure is to provide a system of checks and balances for each system. This is in accordance with the goal of Financial Inventory Accounting that deals with ensuring the integrity of and providing financial safeguards over the inventory accounts. Theoretically, all differences between the two systems should be investigated, reasons for the differences identified, and adjustments made to the system found in error. When errors are found within the Financial Inventory Accounting system, the procedures discussed earlier are utilized to adjust the system accordingly. Theoretically all errors should be identifiable and the appropriate adjustments correctly recorded. However, when specific

identification is not possible at the time of reconciliation, then the Financial Inventory Accounting system is brought into balance using the accounting adjustment entries discussed previously.

K. INTERFACING WITH OTHER CONTROL SYSTEMS

The FIR accounting structure also interfaces with both the monetary reporting structure and the system that monitors transfers between Supply Officers. The main purpose of this interface is to reconcile the information, at the activity level, that is reported to the central accounting office from both reporting systems. In addition, it provides a certain amount of security to the fund or appropriation accounts. The basic concept to reconcile the two systems is the structure designed to match bill payment or transfer information with the information contained in the FIR. The procedures for conducting this matching process are discussed below.

1. Reconciliation of Receipts from Procurement

Receipts from Procurement are taken up in inventory as evidence of receipts arrive in the accounting department via the Inspection Report or automated printout. However, vendors' bills are received and paid at a centralized Financial Information Processing Center through the public voucher system. Periodically, the FIPC reports on these payments by sending the activity abstracted copies of the

public vouchers. This creates a need to maintain some type of system of checks and balances to ensure that payment is made for material received and material not received is not paid for.

Throughout the accounting period receipt documents are matched against copies of abstracted Public Vouchers received from the FIPCs. In essence, the abstracted Public Vouchers are evidence that the government has paid for material that should be on hand within the inventory account. At the end of each accounting period a detailed reconciliation between Inspection Reports and abstracted Public Vouchers is performed and submitted along with the FIR report on NAVCOMPT Form 145 (Reconciliation Statement of Receipts from Purchase). [Ref. 3: pp. 93-106] Figure 2.12 is a sample of the Reconciliation Statement of Receipts from Purchase.

Caption	Description	Amount
(a)	ADD: Public Vouchers Abstracted	\$3,000
(b)	DEDUCT: Abstracted Public Vouchers Returned	\$ 0
(c)	DEDUCT: Reservations and Cash Discounts previously withheld, duplicate payments and other deductions	\$ 500
(d)	ADD: Reservations, Cash Discounts and other additions	\$1,000

Figure 2.12 Reconciliation of Receipts from Purchase

(dd)	ADD: Retail Inventory Loss Allowances	\$ 4
(e)	ADD: Amount Reported Under Caption (h) of Prior NAVCOMPT 145	\$ 380
(f)	DEDUCT: Amount Reported Under Caption (g) of Prior NAVCOMPT 145	\$ 200
(g)	ADD: Unmatched Inspection Reports	\$ 250
(h)	DEDUCT: Unmatched Abstracted Public	\$ 150
	Receipts from Purchase	\$3,784

Figure 2.12 Contd.

Caption (d) of the report represents the total money value of all abstracted Public Vouchers received during the month. Caption (b) is no longer used to indicate Public Vouchers abstracted in error and returned to the abstracting activity; instead the erroneous vouchers are included in caption (a) and a correction notice is sent to the abstracting activity. Credits are then received on the next abstract of Public Vouchers thus reducing the total of caption (a) in the subsequent reconciliation. Captions (c) and (d) account for the following situations:

1. differences between Public Vouchers and Inspection Reports arising from payments of reservations and cash discounts withheld on Inspection Reports
2. differences between Public Vouchers and Inspection Reports arising from non payment of reservations and cash discounts included in Inspection Reports

3. duplicate payments and overpayments detected in the matching process
4. canceled checks and overpayments recovered by disbursing officers
5. differences between approved payment and contract prices
6. Public Vouchers and Inspection Reports under contracts containing advanced payment clauses that are liquidated
7. Public Vouchers and Inspection Reports under cost reimbursable contracts
8. differences of less than \$10 between Public Vouchers and Inspection Reports
9. NSA receipts procured with regular stock fund allotments
10. adjustment of Public Voucher abstracts

Caption (dd) represents the reconciliation of Inspection Reports and abstracted billings from Defense Logistics Agencies, which deduct an allowance from total retail billings as a retail inventory loss allowance. Caption (g) represents the value of all Inspection Reports held by the activity that cannot be matched against Public Vouchers. Caption (h) represents the value of all public vouchers held by the activity that cannot be matched against Inspection Reports. Captions (e) and (f) ensure that the value of the inventory adjusted by captions (g) and (h) only reflect receipts for the current month. The total of the Receipts from Purchase as derived from the Reconciliation Statement should agree with the total value of Inspection Reports received.

When Inspection Reports or Public Vouchers remain unmatched at the end of the accounting period, adjustments must be made in order to bring the Financial Inventory accounts up to date. Unmatched Inspection Reports less than six months old are maintained on file and reported under caption (g) of the Reconciliation Statements. When an Inspection Report remains unmatched for six months, a credit Inspection Report is prepared and reported in the financial accounts under FIR account A8 (Unmatched Inspection Reports and Public Voucher Adjustments). The credit deletes the value of the unmatched Inspection Report from part g of the Reconciliation Statement, and is matched against the unmatched document which is subsequently removed from the unmatched file. An offsetting debit document is also prepared and posted to the inventory account under D5 (Inventory Adjustment (Gains)--Incoming Shipment). The debit and credit adjustment documents are prepared at the same price, usually purchase price, contained in the original Inspection Report. In effect, the entries do not change the value of the inventory account but simply allow the closing of the Inspection Report from an unmatched to a matched classification. The accounting entry appears as follows:

D5 Inventory Adjustment-Incoming	Purch. Price
Shipments	

A8 Unmatched Inspection Reports	Purch. Price
and Public Voucher Adjustments	

Unmatched Public Vouchers are reported under part (h) of the Reconciliation Statement and are deducted from the total because they are theoretically not on hand as part of the inventory. When authorization for adjustment of unmatched Public Vouchers is warranted, a debit Inspection Report is prepared covering the money value of the Public Vouchers to be adjusted. The debit Inspection Report is posted to the inventory under account A8 (Unmatched Inspection Reports and Public Voucher Adjustments), and placed with the unmatched abstracted Public Voucher thus reducing the value of part (h) in the Reconciliation Statement. An offsetting credit document is prepared and posted to account N4 (Financial Adjustments (Reductions)--Accounting Adjustments). As was the case with the adjustment of the unmatched Inspection Reports, the accounting entry does not alter the value of inventory but simply changes the classification of the Public Voucher to a matched status. The accounting entry appears as follows:

A8 Unmatched Inspection Reports and Public Voucher Adjustments	Purch. Price
---	--------------

N4 Financial Adjustments (Reductions)-Accounting Adjustments	Purch. Price
--	--------------

If Public Vouchers and Inspection Reports can not be matched due to differences in price only, then accounting adjustments are made in order to bring the two documents into agreement. When receipts are obtained from a commercial

source (FIR code A1) then differences between Inspection Reports and Public Vouchers are reported as purchase price variances. Account E1 (Financial Adjustments (Gains)--Purchase Variance) is utilized when the value of the Inspection Report is greater than the Public Voucher. Account N1 (Financial Adjustments (Losses)--Purchase Variance) is utilized when the opposite situation occurs. When material is received via other DOD Agencies or other sources, then the differences are reported as standard price adjustments. Account E2 (Financial Adjustments (Gains)--Standard Price Adjustments) and N2 (Financial Adjustments (Losses)--Standard Price Adjustments) are similar to Accounts E1 and N1; the only difference being the source of procurement. Figure 2.13 provides a summary of the accounting entries required for the reconciliation of Receipts from Procurement.

CLEARING UNMATCHED INSPECTION REPORTS

D5 Inventory Adjustments (Gains)	Purch. Price
Incoming Shipment	

A8 Unmatched Inspection Reports	Purch. Price
and Public Voucher Adjustments	

CLEARING UNMATCHED PUBLIC VOUCHERS

A8 Unmatched Inspection Reports	Purch. Price
and Public Voucher Adjustments	

N4 Financial Adjustments	Purch. Price
(Reductions)-Accounting	
Adjustments	

Figure 2.13 Reconciliation of Receipts from Procurement

MATCHING PUBLIC VOUCHER AND INSPECTION REPORT PRICES

COMMERCIAL

E1 Financial Adjustments (Gains)- Price Variance	Insp. Rept. -Pub. Vouch.
N1 Financial Adjustments (Losses)-Price Variance	Pub. Vouch. -Insp. Rept.

OTHER

E2 Financial Adjustments (Gains)- Standard Price Adjustment	Insp. Rept. -Pub. Vouch.
N2 Financial Adjustments (Losses)-Standard Price Adjustment	Pub. Vouch. -Insp. Rept.

Figure 2.13 Contd.

2. Reconciliation of Transfers Between Supply Officers

A matching process between Receipt Invoices and Summarized Invoices is conducted throughout the accounting period, similar to the procedures described for Receipts from Procurement. At the end of each accounting period, a detailed reconciliation between Receipt Invoices and Summarized Invoices is performed and submitted along with the FIR report on NAVCOMPT 146 (Reconciliation Statement of Receipts from other Supply Officers). [Ref. 3: pp. 106-114] Figure 2.14 is a sample of the Reconciliation of Receipts from other Supply Officers.

Caption (A) contains the total monetary value of summaries received. Caption (B) represents Receipt invoices of less than \$100 that cannot be matched with Summarized Invoices. Captions (C) and (E) are utilized to adjust the

report for unmatched Receipt and Summarized Invoices. The adjustment resulting from captions (D) and (F) ensure that the inventory adjustments from captions (C) and (E) only reflect receipts from the current period. The results of the computations contained within the Reconciliation Statement will equal the total Receipts from other Supply Officers during the period.

CAPTION	DESCRIPTION	AMOUNT
(A)	ADD: Summaries Received	\$2,000
(B)	ADD: Receipt Invoices less then \$100 each not summarized	\$ 1
(C)	ADD: Unmatched Receipt Invoices	\$1,000
(D)	ADD: Previous Caption (C)	\$ 800
(E)	DEDUCT: Unmatched Summarized Invoices	\$1,500
(F)	DEDUCT: Previous Caption (C)	\$ 950
	Receipts from OSO	\$2,351

Figure 2.14 Reconciliation Statement of Receipts from Other Supply Officers

At the end of each accounting period adjustments are made in order to bring the inventory accounts up to date. Adjustment of unmatched NSA documents of less than \$1,000 and APA documents of less than \$2,500 is generally authorized when Receipt Invoices are 6 months old. Monetary values greater than this amount must remain on file and are followed up continuously until corrective action is taken by

the shipping activity. Unmatched receipt documents are reported under caption (C) of the statement and are added to the value of summaries received to arrive at receipts actually in inventory. Therefore, any adjustment that alters the unmatched status of the document must be made with a credit entry. When adjustment is authorized, a credit receipt is posted to inventory under FIR account F6 (Unmatched Receipt and Summarized Invoice Adjustments (Stock)) or F7 (Unmatched Receipt and Summarized Invoice Adjustments (Immediate Use)) depending upon the type of receipt under adjustment. An offsetting debit document will be prepared and posted to inventory under FIR account D5 (Inventory Adjustment (Gains)--Incoming Shipment). The credit receipt serves to decrease the value of Unmatched Receipt Invoices as reported in part (C) of the Reconciliation Statement. The accounting entry does not alter inventory totals but simply changes the status of the unmatched invoice. When the unmatched receipt document is for a credit to the receiving activity, the alternate entry will be made. Samples of each entry are as follows:

STANDARD RECEIPT INVOICE

D5 Inventory Adjustment (Gains)	Stan. Price
Incoming Shipment	
F6 Unmatched Receipt and	Stan. Price
Summarized Invoice Adjustments	

CREDIT RECEIPT INVOICE

F6 Unmatched Receipt and	Stan. Price
Summarized Invoice Adjustments	

**M5 Inventory Adjustment (losses)
Incoming Shipment**

Stan. Price

Unmatched Summarized Invoices may be adjusted under the same monetary and aging requirements described for Receipt Invoices. Unmatched Summarized Invoices are reported in part (E) of the Reconciliation Statement and are deducted to arrive at the total receipts figure. Therefore, any adjustment to alter it from the unmatched category must be a debit entry. When adjustment is authorized, a debit invoice is prepared and posted to inventory under FIR account F6 (Unmatched Receipts and Summarized Invoice Adjustment (Stock)) or F7 (Unmatched Receipt and Summarized Invoice Adjustment (Immediate use)). The debit invoice is matched with the unmatched Summarized Invoice, which reduces the value of unmatched Summarized Invoices reported in part (E) of the Reconciliation Statement. An offsetting credit document is prepared and posted to inventory under account M5 (Inventory Adjustments (Losses)-Incoming Shipment). As is true with all matching adjustments, the offsetting entries do not alter the total value of inventory but simply change the status of the unmatched Summarized Invoice. The accounting entry appears as follows:

F6 Unmatched Receipt and Summarized Invoice Adjustments	Stan. Price
--	-------------

M5 Inventory Adjustments (Losses)-Incoming Shipment	Stan. Price
--	-------------

When Receipt and Summarized Invoices cannot be matched due to a difference in price only, then an accounting adjustment is made in order to bring the two documents into agreement. When the Receipt Invoice is greater than the Summarized Invoice, the difference between the two prices is entered into the accounts in the same manner as described above for adjusting unmatched Receipt Invoices. When the Summarized Invoice is greater than the Receipt Invoice, the difference in the two prices is entered into the accounts in the same manner as described above for adjusting unmatched Summarized Invoices. Each entry adjusts the value of the inventory to summarized prices. Figure 2.15 provides a summary of entries required for the reconciliation of Receipts from Other Supply Officers.

CLEARING UNMATCHED RECEIPT INVOICE

D5 Inventory Adjustment (Gains)- Incoming Shipment	Recpt. Price
---	--------------

F6 Unmatched Receipt and Summarized Invoice Adjustments	Recpt. Price
--	--------------

CLEARING UNMATCHED SUMMARIZED INVOICES

F6 Unmatched Receipt and Summarized Invoice Adjustments	Summ. Price
--	-------------

M5 Inventory Adjustments (Losses) Incoming Shipment	Summ. Price
--	-------------

Figure 2.15 Reconciliation of Transfers from Other Supply Officers

MATCHING RECEIPT AND SUMMARIZED INVOICE PRICES

When Receipt Price is Greater

D5 Inventory Adjustments (Gains)	Recpt. Price
Incoming Shipment	-Summ. Price

F6 Unmatched Receipt and	Recpt. Price
Summarized Invoice Adjustments	-Summ. Price

When Summarized Price is Greater

F6 Unmatched Receipt and	Summ. Price
Summarized Invoice Adjustment	-Recpt. Price

M5 Inventory Adjustment (Losses)	Summ. Price
Incoming Shipment	-Recpt. Price

Figure 2.15 Contd.

L. COMPILATION OF ACTIVITY REPORTS

At the end of each accounting period the central accounting office compiles the totals contained in each FIR report into a summary report in the same format. Financial Statements (i.e. Balance Sheets and Income Statements) are prepared for each inventory account based upon the FIR report and the monetary transaction data provided from the Financial Information Processing Centers throughout the period. Since the bottom line of each FIR report is the value of inventory on hand, the total value of all FIR reports is utilized as the value of inventory on hand listed under the assets section of the Balance Sheet. In addition, transaction totals, supporting documentation such as the Reconciliation statements, and reported differences between the monetary and inventory systems are utilized to

complete various other sections of both the Balance Sheet and Income Statement. The procedures utilized to transpose this compiled information into financial statement format will be covered in depth in Chapter 3.

M. FINANCIAL INVENTORY ACCOUNTING PROBLEMS

During fiscal years 1977 and 1978 the Naval Audit Service conducted a system-wide audit on the Financial Inventory Accounting System. The purpose of this audit was to appraise the adequacy and reliability of the system, and the data reported to management in the FIR report. The review included four areas; 1. reconciliation between stock and financial records, 2. stores document matching, 3. financially suspended transactions, and 4. physical inventory adjustments. The conclusions of the Audit found the data reported by the system to be replete with errors and questioned the credibility of any decisions based upon the data. Specifically, the audit report recommended that 1. the inventory system be revised with a view toward developing a more simple and direct control system, that would provide more accurate and meaningful data for Navy Supply Systems Assets and 2. that the requirements for matching receipt and financial documents for receipts from commercial procurements and transfers from other supply officers be eliminated. It was the contention of the auditors that the matching process merely duplicated

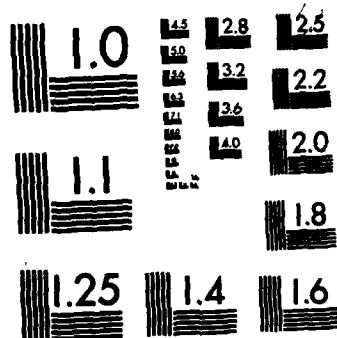
AN ANALYSIS OF THE FINANCIAL INVENTORY REPORTING
STRUCTURE(U) NAVAL POSTGRADUATE SCHOOL MONTEREY CA
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MICROCOPY RESOLUTION TEST CHART
NATIONAL BUREAU OF STANDARDS-1963-A

the receipt control procedures imposed by the material due files utilized in the stock record system. [Ref. 6: p. 1]

The Audit Services review of reconciliations between stock and financial records found that reconciliations were not always meaningful. The auditors reviewed reconciliations of material valued at \$2.2 billion with initial differences of \$265.9 million requiring adjustment. Adjustments of \$483.5 million (in terms of absolute value) were made to bring the stock and financial records into agreement. Included in this total were \$141.7 million worth of unsupported money value only transactions, \$5.0 million worth of invalid adjustments, \$14.2 million worth of unreconciled differences, and \$18.1 million worth of improper FIR code usage. The error classified as unsupported money value only transactions was a result of misstatement of the type of adjustment required. In essence, the value of the unsupported transactions should have been made to various financial and inventory adjustment accounts, such as transfers between condition or material control codes and standard price adjustments; instead, the adjustments were made as accounting adjustments. [Ref. 6: pp. 4 and 10] Correction of these errors will not change the value of the financial records, and thus create an additional imbalance between the two systems. However, the value of the inventory accounts are still misstated and provide management with erroneous information.

The error classified as invalid adjustments represent transactions that had previously been adjusted prior to the reconciliation statement. Not only does this type of error misstate the information contained in the inventory accounts, but correction of this error will create an additional imbalance between the two systems. This would indicate the existence of unrectified accounts within the system. The error classified as unreconciled differences represents situations where differences were not reconciled or improper amounts were utilized when adjustments were made. This also indicates an imbalance that requires further investigation. The error relating to improper utilization of FIR codes resulted when transactions were recorded to the wrong accounts or adjustments were made against wrong codes. The error results in misstated information within the inventory accounts, but does not indicate the existence of a remaining imbalance. [Ref. 6: pp. 3-11]

The Audit also found that the value of unmatched documents was significantly misstated as a result of arbitrary write offs of both receipt and financial documents, misclassified receipts, and negative transactions included in the activities records. In general misclassified receipts represent the major reason that receipt and financial documents do not match. It is the opinion of the Audit Service that the matching process should be eliminated because it simply is not effective and duplicates the receipts control

procedures provided for by the supply system. This reflects the fact that the matching process is mainly utilized to report the value of Material In Transit, as discussed in Chapter 3. The report, however, does not address how the accounting department will ensure that the activity actually receives the material that is paid for through the voucher system or is charged to the activity through transfers.

[Ref. 6: p. 12]

The Audit Services' review of financially suspended transactions found that FIR data may be misstated by as much as \$103 million at any given time. Financially suspended transactions represent receipts, issues, and adjustments that have been posted to the stock records but not to the financial records. The major reason that transactions financially suspend is due to the complexity of both the financial accounting and supply systems. Under UADPS, at least 10,000 codes are involved in processing transactions and the use of a wrong code or combination of codes will cause a transaction to suspend. In addition, the turnover rate is high for personnel involved in these systems and newer personnel will be prone to more mistakes. [Ref. 6: pp. 22-24]

The last area looked at by the Audit Service was physical inventory adjustments. These adjustments result when the amount of material present in the warehouse, as determined by actual count, differs from the stock records.

It is self evident that the financial records, which are designed to match the stock records, can only be reliable to the extent that the warehouse inventory is accurately reflected on these stock records. The audit found physical inventory adjustments in the amount of \$780 million, which represented the total of net gains and losses. This reflected a significant distortion in the data reported on the FIR report in periods prior to the adjustment.

[Ref. 6: pp. 24-27]

The Audit Service was also concerned with the dollar value of total adjustment transactions reported on the FIR report. A review of the adjustment transactions indicated that a total monetary value of \$29.3 billion worth of adjustments were made during the same period that receipt and issue transactions totaled only \$29.2 billion.

[Ref. 6: p. 3] The Naval Supply Systems Command (NAVSUP), in its comments to the audit report, indicated that only \$2.6 billion of this total represented true adjustments to inventory. The remainder were financial management entries used by the inventory managers, NAVSUP, and budget reviewers in support of the budgetary process, in pricing calculations, and in financial control of inventories. A review of the procedures contained in this chapter indicate that this is quite likely. However, if this is the case, then true adjustments still represent almost 10% of total transactions. Further, the use of subsidiary inventory accounts

with adjustment titles for the collection of financial management data is highly misleading.

Significant disagreement has surfaced concerning the specific findings of the Audit Service since its initial report was published in February of 1979. However, most people involved with the system agree with its basic premise that a simpler, more direct method of financially accounting for inventory is required. Before any system can be modified or rebuilt, the basic requirements of the system must be identified and adhered to in subsequent redesign. In this light, the remainder of this thesis will identify the basic requirements of Financial Inventory Accounting within the Navy, review how the present system meets or fails to fulfill those requirements, and explore possible modifications that could simplify the present accounting structure.

III. THE LEGAL REQUIREMENTS AND GOVERNING REGULATIONS

A. BACKGROUND

Chapter Two provided the background that will be utilized in the analysis contained in the remainder of this thesis. As is obvious from the material within that chapter, Navy desperately needs to simplify its FIR structure. There are at least two basic possibilities for simplification. First, the complex level at which the subsidiary inventory accounts are maintained and from which the FIR Reports are built can be significantly simplified. At the present time FIR accounts are maintained at a level designated by various combinations of condition codes and material control codes within each cognizance symbol. Since there are 25 condition codes and 14 control codes, this would indicate a possible 350 combinations within each cognizance symbol. Since there are 89 cognizance symbols utilized by inventory managers, this would indicate a possible 31,150 coding combinations just to place the inventory transaction into its proper level. Although not all material control codes and condition codes are utilized for each cognizance symbol, the resultant number is still enormous. Therefore, it is relatively easy to understand why financial transactions suspend on a frequent basis. This is without considering the special accounting classifications maintained at

most activities, as discussed in Chapter 2, which complicates the system even further. Second, the FIR reporting structure can be simplified by reducing the number of FIR coded subsidiary accounts which also contributes to the systems complexity.

However, before any attempt can be made to reduce either the level of accounting or the number of subsidiary inventory accounts, one must fully understand the reasons for the FIR structure. The reasons for the existence of the FIR can be placed into two separate categories; 1. legal requirements and governing regulations, which include external reporting requirements, and 2. implicit requirements, which include both the maintenance of inventory integrity and the provision of budgetary information to inventory managers. This chapter discusses how the present FIR structure fulfills its legal requirements and governing regulations. Chapter 4 explores the manner in which the present FIR structure fulfills its implicit requirements. Chapter 5 then summarizes the analysis contained within Chapters 3 and 4 and makes specific recommendations for improvement to the FIR reporting structure.

Although Chapter 5 deals with the conclusions and recommendations of the analysis contained in Chapters 3 and 4, it is helpful to explore possible reductions in complexity as they become clear during the discussion of the present FIR structure. Three underlying themes should become evident as

the requirements of the FIR structure are analyzed. First, it is possible to maintain the subsidiary accounts, and the FIR report itself, at the cognizance symbol level vice the complex level it is now maintained. Institution of this single concept would significantly contribute to solving numerous problems experienced by the present FIR structure. Second, it is possible to significantly reduce the number of subsidiary accounts presently maintained. Third, there are a number of cases where additional subsidiary accounts would make the FIR structure more efficient in meeting its legal and implicit requirements. These themes should become obvious as the analysis of Chapters 3 and 4 are discussed.

B. GENERAL

The legal requirement for financial inventory accounting within the armed forces is established by the National Security Act of 1947 and Title 10 U.S. Code. Essentially, the law sets forth the requirement that some form of financial inventory accounting be maintained and gives the responsibility for how it is conducted to the Secretary of Defense. The following is the entire text of the law as it appears in Article 2701 of the National Security Act of 1947 and Title 10 of the U.S. Code.

"Under the regulations prescribed by him, the Secretary of Defense shall have records of the fixed property, installations, major equipment, items, and stored supplies of the military departments maintained on both a quantitative and monetary basis, so far as practical. The

Secretary shall report once a year to Congress and the President on property records maintained under this section."

It is clear from this short article that the law requires financial records to be maintained by each military department for the value of its inventory accounts. The implication of the law that financial records will be maintained as prescribed by the Secretary gives the resultant governing regulations issued under his hand the full weight of the law.

Governing regulations for the maintenance of financial records for stock fund inventory accounting are contained in Department of Defense Instruction Number 7420.11 (DOD INST 7420.11). Unfortunately, the Secretary of Defense has not issued any governing regulations concerning accounting for and reporting appropriated purchase accounts and associated inventories. With this lack of formal guidance, Navy has chosen to utilize the same accounting system to maintain financial inventory records for APA inventories as is established to account for stock fund inventories. Therefore, it is considered reasonable to judge how the Navy's financial inventory accounting system fulfills its legal requirements and governing regulations by making a systematic comparison of the present structure with the regulations contained in DOD INST 7420.11.

The formal subject title of DOD INST 7420.11 is; Chart of Accounts and Financial Reports for Department of Defense

Stock Funds. As its name indicates, the regulation details a specific chart of accounts to be utilized by all military department stock funds and a reporting structure that utilizes the detailed chart of accounts. Essentially, the Chart of Accounts prescribes the accounts that will be maintained by the central accounting office and utilized in the preparation of its Balance Sheet and Income Statement. The Chart of Accounts is mandatory and no changes are authorized without the prior approval of the DOD comptroller. Subsidiary accounts may be established but must aggregate directly to the prescribed control accounts.

C. CHART OF ACCOUNTS

There are two separate types of accounts contained within the prescribed DOD Chart of Accounts; balance sheet accounts and income statement accounts. The balance sheet accounts are stock accounts. Essentially, stock accounts are established to reflect the value of a certain item at a certain period in time, usually as of the end of the accounting period. For example, an asset account entitled "cash" in the balance sheet would reflect the amount of cash on hand as of the balance sheet date. The accounts are classified in the same manner as balance sheet accounts in all nonprofit organizations; assets, liabilities, and capital. Figure 3.1 provides a summary of the accounts in Balance Sheet form. [Ref. 7: pp. 1-3]

ASSETS

Cash Available for Disbursement	XXXX
Unallocated Cash	XXXX
Accounts Receivable-U.S. Government Agencies	XXXX
Accounts Receivable-other	XXXX
Inventories-Stock on Hand	XXXX
Inventories with Contractors and Testing Agencies	XXXX
Inventories in Process of Assembly/Disassembly	XXXX
Consigned Inventories	XXXX
Inventories Temporarily in Use	XXXX
Inventories in Transit-from Procurement	XXXX
Inventories in Transit-between Storage	XXXX
Inventories in Transit-from customers	XXXX
Undelivered Purchases-Capitalized Contracts	XXXX
Progress Payments to Contractors	XXXX
Advanced Payments to Contractors and Suppliers	XXXX
Claims Receivable	XXXX
Undistributed Disbursements	XXXX
Other Assets	XXXX

LIABILITIES

Accounts Payable-U.S. Government Agencies	XXXX
Accounts Payable-Other	XXXX
Stock Withdrawal Credits Unapplied	XXXX
Undistributed Collections	XXXX
Reserve for Equity of Others (Except International Cooperative Logistics)	XXXX
Reserve for Equity of Others (International Cooperative Logistics Support)	XXXX
Other Liabilities	XXXX

CAPITAL

Direct Appropriations	XXXX
Cash Allocations (Net)	XXXX
Cash Transfers to U.S. Treasury	XXXX
Cash Transfers to Appropriations	XXXX
Cash Transfers from Appropriations	XXXX
Capitalized Inventories	XXXX
Inventories Decapitalized	XXXX
Capitalized Undelivered Purchases	XXXX

Figure 3.1 Summary of Balance Sheet Accounts

Stock Withdrawal Credits	XXXX
Other Assets Capitalized/Decapitalized	XXXX
Other Liabilities Capitalized/Decapitalized	XXXX
Operating Results	XXXX

Figure 3.1 Contd.

In contrast, income statement accounts are flow accounts that reflect changes occurring in an accounting period. They report the change in the value of the stock fund that occurs in a given period of time and are closed to operating results (contained in the balance sheet) at the end of the accounting period. The income statement accounts are classified as either income or expense in a manner similar to income statement accounts in all nonprofit organizations. These accounts are summarized in Figure 3.2 in Income Statement form. [Ref. 7: pp. 4-5]

INCOME

Reimbursable Issues (Gross)	XXXX
Surcharge for Inventory Losses	XXXX
Surcharge for Transportation	XXXX
Purchase Price Variance-Gain	XXXX
Credit Allowed on Returned Material	XXXX
Discounts Earned on Purchases	XXXX
Authorized Discounts Lost on Purchase	XXXX
Discounts on Material Returns-Gains	XXXX
Recoveries for Retail Stock Losses	XXXX
Material Returned Credits Received	XXXX
Assembly/Disassembly-Gain	XXXX
Standard Price Changes-Gain	XXXX
Physical Inventory Adjustments-Gains	XXXX
Accounting Adjustments-Gains	XXXX
Receipt of Material Returns without Credit	XXXX
Proceeds from Disposal of Excess Material	XXXX
Trade in Allowances on Purchases	XXXX

Figure 3.2 Summary of Income Statement Accounts

Receipts of Material without Charge	XXXX
Incoming Shipments-Gain	XXXX
Other Income	XXXX
EXPENSES	
Purchases at Cost	XXXX
Cost of Sales at Standard Price	XXXX
Purchases at Standard Price	XXXX
Price Variance Distribution Account	XXXX
Purchase Price Variance-Loss	XXXX
Accounting Adjustments-Loss	XXXX
Physical Inventory Adjustments-Loss	XXXX
Standard Price Changes-Loss	XXXX
Assembly/Disassembly-Loss	XXXX
Price Reductions on Sales	XXXX
Discounts on Material Returns-Loss	XXXX
Transfers to Property Disposal	XXXX
Discounts Lost on Purchases	XXXX
Material Returns for Credit	XXXX
Transportation Expense	XXXX
Repair Expense	XXXX
Material Returned Credits Applied	
Inventory Loss Due to Shrinkage, Theft,	XXXX
Contamination and Deterioration	XXXX
Inventory Loss Due to Major Disasters	XXXX
Trade Ins on Purchases	XXXX
Issues without Reimbursement	XXXX
Material Returns without Credit	XXXX
Allowances for Retail Stock Losses	XXXX
Incoming Shipments-Loss	XXXX
Other Expense	XXXX

Figure 3.2 Contd.

Information included in these financial statements are received from both the monetary and inventory accounting systems. The purpose of the FIR reporting structure is to provide inventory information to the central accounting office for inclusion in the chart of accounts financial statements. Therefore, the measure of effectiveness of the FIR structure in conforming to its governing regulations is

the degree of difficulty required to place data from the FIR structure into chart of accounts format. The inventory information necessary for the construction of the chart of accounts is taken from the summary report prepared by the central accounting office through a compilation of activity reports. The information required for the chart of accounts is at the inventory account level only (i.e. NSA). Therefore, the complex level of detail at which the subsidiary inventory accounts are maintained is not utilized for the purposes of fulfilling legal requirements and submitting external financial reports.

Information from the FIR report and its associated documentation is transformed to the chart of accounts in three ways. First, information that directly reports inventory transactions or inventory levels are transcribed directly from the compiled FIR report. Second, information that reflects differences between monetary transaction totals and inventory transaction totals are reconciled and recorded in some manner. Third, changes to monetary accounts that result directly from inventory transactions (such as issues and receipts) are reconciled and recorded in the chart of accounts.

D. BALANCE SHEET ACCOUNTS

Since the stock fund maintains a constantly revolving amount of capital, it is only logical that DOD reporting

requirements would adopt balance sheet accounting similar to that utilized by all major nonprofit organizations. Balance Sheet accounting provides a strong management control system because it forces inventory managers to be able to account for the entirety of the capital invested, regardless of the form it is in. The balance sheet accounts are separated into Assets, Liabilities, and Capital in accordance with classic accounting theory. The assets of the stock fund reflect the total dollar value contained in monetary and inventory accounts owned by the fund. There are five types of asset accounts; 1. monetary accounts presently on hand, 2. monetary accounts receivable, 3. inventory accounts on hand, 4. inventory accounts receivable and in transit, and 5. assets of the fund that are not directly related to inventories.

In its simplest form, the assets of the stock fund should equal the total capital invested. However, it is not always easy to make direct transactions in today's world and liability accounts are established to show the amount of debt owed by the stock fund. These accounts reflect the amount of assets that are presently held but not financed directly with invested capital. The liability accounts can be classified as; 1. accounts payable, 2. stock withdrawal credits, 3. undistributed collections, and 4. reserves for the equity of others. Liability accounts are monetary

accounts because, in essence, they reflect the value of cash owed to other inventory accounts or appropriations.

Capital accounts are utilized to show the value of invested equity in the stock fund. In most nonprofit organizations the capital section of the balance sheet is small and shows merely the amount of original invested capital and operating results. Due to the fact that changes occur frequently to the overall value of the fund from external action, the capital accounts are quite extensive and serve to reflect these changes. The capital accounts can be classified as follows: 1. direct appropriations, which include the initial and any subsequent appropriations by Congress, 2. cash allocations and transfers, 3. capitalized and de-capitalized inventories, 4. stock withdrawal credits, 5. capitalization of other assets, and 6. operating results. The capital accounts reflect changes to the value of the stock fund that result from both monetary and inventory type transactions.

The information contained within the Balance Sheet is obtained through a number of ways; 1. inventory on hand information obtained directly from the FIR reporting system, 2. inventory due in information obtained via a reconciliation between the FIR and the monetary reporting system, 3. on hand and due in monetary information obtained directly from the monetary reporting system, 4. inventory due in information obtained directly from the monetary reporting

system and 5. information maintained centrally and reported by neither accounting system. The illustration below portrays the various sections of the balance sheet in the form information is obtained.

BALANCE SHEET

ASSETS

Obtained Directly from Monetary Accounting System

- Cash Available for Disbursement
- Unallocated Cash
- Accounts Receivable-U.S. Government Agencies
- Accounts Receivable-other
- Undelivered Purchases-Capitalized Contracts
- Progress Payments to Contractors
- Advanced Payments to Contractors and Suppliers
- Claims Receivable
- Undistributed Disbursements

Obtained Directly from FIR Reporting System

- Inventories-Stock on Hand
- Inventories with Contractors and Testing Agencies
- Inventories in Process of Assembly/Disassembly
- Consigned Inventories
- Inventories Temporarily in Use

Obtained from Reconciliation between both Systems

- Inventories in transit-from Procurement
- Inventories in transit-between Storage
- Inventories in transit-from customers

Neither

- Other Assets

LIABILITIES

Obtained Directly from Monetary Accounting System

- Accounts Payable-U.S. Government Agencies
- Accounts Payable-other
- Stock Withdrawal Credits Unapplied
- Undistributed Collections
- Reserve for Equity of others (both cases)

Neither

Other Liabilities

CAPITAL

Obtained Directly from Monetary Accounting System

Direct Appropriations

Cash Allocations

Cash Transfers to Appropriations

Capitalized Undelivered Purchases

Stock Withdrawal Credits

Obtained Directly from FIR Reporting System

Capitalized Inventories

Inventories Decapitalized

Neither

Other Assets Capitalized/Decapitalized

Other Liabilities Capitalized/Decapitalized

Operating Results (this figure is calculated from
Income Statement)

E. ASSETS

The illustration above clearly indicates two types of asset accounts that obtain their information utilizing the FIR, 1, when information is obtained directly from the FIR and 2. when information is obtained as a result of a reconciliation process between the two systems. The analysis below addresses these two types of accounts. The remaining asset accounts do not utilize the FIR reporting structure and are therefore irrelevant to the discussion contained within this thesis.

1. Accounts Maintained Directly from the FIR Reporting System

The structure of the FIR report is designed to report the value of inventory on hand at the accountable activity as of the end of the accounting period, which would directly relate to the chart account Inventories-Stock on Hand. However, the FIR structure also includes information pertinent to the value of the following special inventory accounts: Inventories with Contractors and Testing Agencies, Inventories in Process of Assembly/Disassembly, Consigned Inventories, and Inventories Temporarily in Use. Therefore, if the central accounting office is to maintain these accounts on a separate basis, it is sometimes necessary to deduct the value included in these accounts from the value reported by the compiled summary FIR report when transposing the FIR data to the chart account Inventories-Stock on Hand. The compiled summary FIR report is simply the compilation of all activity FIR reports at the inventory account level (i.e. NSA). All information required for the maintenance of the above chart accounts at the central accounting office is included some place within the compiled summary and individual activity copies of the FIR report.

The first chart account appearing on the balance sheet after Inventories-Stock on Hand is Inventories with Contractors and Testing Agencies. The account is designed to show the value of inventories in the possession of

contractors or testing agencies for processing or repair.

[Ref. 7: p. 8] The account is maintained centrally, but is updated through transaction information taken from the FIR reports. Update information is not taken from the compiled summary FIR report but rather the combined FIR reports of SPCC and ASO. Since SPCC and ASO are merely Inventory Control Points, and therefore, do not hold material in stock, the FIR reports submitted by them are utilized to report special situations. This is the case with the information that provides updated data to the chart account Inventories with Contractors and Testing Agencies. The amount reported under FIR Account F4 (Transfers from other Supply Officers--Stock Transfers) reflects the amount of material transferred from stock to a contractor, industrial fund, or testing agency and is debited to the account. The amount reported under FIR Account P4 (Transfers to other Supply Officers--Stock Transfers) reflects the value of material returned to stock from the same sources and is credited to the account. The total effect of the two entries is to correctly account for the total change in the value of inventory at contractors and testing agencies. The value of these transactions have been included in calculating the closing balance contained within the FIR report. They must therefore be backed out of the compiled summary FIR report prior to its transposition to the chart account Inventory-Stock on Hand.

The chart account Inventories in Process of Assembly/Disassembly reports the value of material in process of assembly, disassembly, conversion, modification, and repair at storage or warehouse locations. Furthermore, the regulations require that subsidiary accounts be maintained on the material in process of assembly/disassembly. [Ref. 7: p. 9] The account is maintained centrally and is updated by information as reported in the FIR report. Gains reported to the inventory on hand by account E5 (Financial Adjustmnets (Gains)--Assembly/Disassembly) are in actuality losses to the account and should be credited accordingly. Losses reported by the FIR Account N5 (Financial Adjustments (Losses)--Assembly/Disassembly) are gains to the chart account and should be debited. Since the value of the adjustments made to the chart account Inventories in Process of Assembly/Disassembly has no effect on the amount reported in the closing balance of the FIR report no corresponding adjustment is required prior to transposition. However, it should be noted that no financial information on the value of inventories in this category is maintained at the activity level. Since this type of information is available within the stock records, and is necessary for financial reporting, it would seem logical that this type of account be maintained. This would require the addition of a subsidiary account which could be updated with the same information as described above.

The chart account Consigned Inventories is maintained to show the value of material consigned by the stock fund to activities for subsequent reissue as Inventories Temporarily in Use. The chart account Inventories Temporarily in Use reports the value of material issued on a temporary loan basis and must be subsequently returned to the stock fund. The value of all material not returned or returned in an unserviceable condition is billed as a reimbursable sale. [Ref. 7: pp. 10-11] Navy rarely if ever reports items either under the Consigned Inventories or Inventories Temporarily in Use categories. Although clothing items are issued to Navy Exchanges and Ships Stores on a consigned basis, their ultimate destination is intended for resale vice temporary issue. Therefore, their transfer and return are more accurately reported as inventory adjustments. However, the requirement does exist to keep this data segregated in order to facilitate funding transfers between NRSO and the stock fund.

2. Accounts Maintained by Reconciliation of the Two Systems

Three types of Inventories in Transit accounts are required by the chart of accounts; Inventories in Transit--from Procurement, Inventories in Transit--Between Storage Points, and Inventories in Transit--From Customers.

[Ref. 7: pp. 12-14] The chart account Inventories in Transit--from Procurement utilizes information taken from both

the Monetary and Inventory reporting systems. The account is maintained centrally and utilizes procedures similar to the matching process at the activity level for receipts from procurement. Essentially, the central accounting office considers the difference between the value of the total abstracted public vouchers as reported under the monetary system and the Total Receipts from Procurement as reported under the Inventory system as the value of Inventories in Transit--from Procurement. It is assumed that material that was paid for but not received must essentially be in transit; an assumption that will no doubt hold true in most cases. However, there are times when unmatched public vouchers and Inspection Reports will never ultimately be matched and procedures are established to reclassify these unmatched entries into matched status. The Reconciliation Statement and its associated FIR account A8 (Unmatched Inspection Reports and Public Voucher Adjustments) are utilized to adjust the chart account Inventories in Transit--from Procurement for the value of reclassification after a six month period.

Inventories in Transit-Between Storage Points is maintained to account for the value of inventory shipped to other Supply Officers within the same stock fund account. The procedures for the maintenance of this account is similar to that described above for Inventories in Transit--from Procurement. Shipments of stock are reported to the

central accounting office via the "Summary of Transfers to other Supply Officers" as described in Chapter 2. The information contained in the Summaries received is compared with the value of FIR account F4 (Transfers from other Supply Officers--Stock Transfers) and reported as the value of Inventories in Transit--Between Storage Points. A reconciliation process, similar to that described above, takes place for transfers from other Supply Officers and is utilized to make adjustments to the value of Material in Transit in a similar manner. The FIR account utilized to reclassify unmatched summary and receipt invoices is F6 (Unmatched Receipt and Summarized Invoice Adjustments).

Inventories in Transit--from Customers is maintained to show the value of material in process of return to an accountable activity. This account is also maintained separately under procedures similar to those described above. When material is returned for credit, a credit document is issued and payment is made by the FIPC. The difference between the value of credits paid and the total value reported under FIR Account J2 (Issues with Reimbursement--Returns--Service Use) and J4 (Issues with Reimbursement--Returns--other than Service Use and MAPS) is considered as in transit and debited to chart account Inventories in Transit--from Customers. No extensive matching process exists as with the other two accounts. It is assumed by the

accounting system that material for which credit is given will eventually be returned by the customer.

The remainder of the asset accounts are either strictly monetary accounts or inventories receivable for which money has been paid but no material exists within the system at the present time. In both instances, the information required for maintenance of these accounts is derived totally from the monetary accounting system. For this reason, they are considered irrelevant to the present analysis and will not be discussed in any detail.

F. LIABILITIES

In total, liability accounts are monetary accounts that simply reflect the amount of money owed by the stock fund. They account for the difference between the total asset value of the fund and the amount of invested capital. Since liabilities are monetary accounts, their maintenance is not dependent upon the inventory reporting system. For this reason it is not necessary to discuss liabilities in any great detail.

G. CAPITAL

All Capital accounts are maintained centrally by the central accounting office. The main capital account reflects invested capital granted by Congress as described in Chapter 2. A number of the other capital accounts

reflect decisions made by external organizations, such as Congress, that reflect changes to the value of invested capital based upon receipt by the central accounting office of the external decision. However, a few accounts also reflect the implementation of policy decisions and are reported to the central accounting office via the monetary and inventory reporting systems.

The implementation of policy decisions concerning the capitalization and decapitalization of inventory into and out of the stock fund is reflected in two accounts as designated by the chart of accounts, Capitalized Inventories and Inventories Decapitalized. [Ref. 7: pp. 31-32] The value of these accounts is maintained on a central basis but are updated through the compiled summary FIR report via two FIR accounts that report directly on these values. These FIR accounts are B4 (Receipts without Reimbursement--Capitalization) and K5 (Issues without Reimbursement--Recapitalization).

H. SUMMARY OF BALANCE SHEET CONCLUSIONS

There is sufficient information contained within the FIR reporting structure to meet its requirements for transposition to the balance sheet accounts prescribed by the Chart of Accounts. However, a few modifications could make the reporting structure less complex. First, nowhere is the level of detail that FIR accounts are maintained at utilized within the balance sheet. Second, information on the value

of inventories in process of assembly/disassembly is only available centrally. The establishment of a subsidiary account utilizing the same title would simplify the accounting procedures at the central accounting office. In addition, more control would be available at the activity level. The structure of this account should allow for increases and decreases to be made directly to the account. This would eliminate the gain and loss subsidiary accounts now in use.

The transposition of the data for the chart account Inventories with Contractors and Testing Agencies is not very complicated, but appears confusing because it is labeled in the FIR report as Transfers from or to other Supply Officers. This is necessary in order to be able to properly account for material in this category that is in transit without the development of an entire new system for material in transit to contractors and testing agencies. In this case the slight confusion is well worth the extra paperwork and confusion that reclassification and labeling of a new system would entail.

I. INCOME STATEMENT ACCOUNTS

Changes that occur to the value of the stock fund due to operations are reflected in Income Statement accounts. In addition, the Income Statement accounts reflect the changes in the way the assets of the account are held (i.e. how much

in cash, how much in inventory, etc.)). The accounts contained in the income statement are classified as to Income and Expenses. Income accounts reflect the increases that occur to the value of the stock fund during the accounting period. There are four types of accounts contained within the Income section: 1. accounts which reflect changes in monetary values only, 2. accounts which reflect changes in inventory only, 3. accounts that reflect changes in monetary values as a result of changes in inventory, and 4. the other income account which is maintained centrally without supporting information from either the monetary or inventory accounting systems.

In contrast, expense accounts reflect the decreases that occur during the accounting period. Expense accounts may be classified into the same four types as discussed above. It should be remembered that the objective of the stock fund is merely to break even, in the long run, with income equal to expenses. However, it is rarely the case that the fund is able to accomplish this. The difference between the totals in the income and expense sections is closed to operating results contained within the Capital section of the Balance Sheet at the close of each accounting period. In essence, operating results are similar to the Retained Earnings account utilized in private industry.

The information contained within the Income Statement accounts is also obtained through a number of ways;

1. information reflecting monetary transactions only taken directly from the monetary reporting system, 2. information reflecting inventory transactions only taken directly from the FIR report, 3. information reflecting monetary transactions resulting from inventory transactions taken primarily from the monetary reporting structure but reconciled with the FIR, and 4. information maintained centrally and not obtained from either system. The illustration below portrays the various Income Statement accounts in the form that information is portrayed.

INCOME STATEMENT

INCOME

Obtained Directly from Monetary Reporting System

- Surcharge for Inventory Losses
- Surcharge for Transportation
- Discounts Earned on Purchases
- Authorized Discounts Lost on Purchase
- Proceeds from Disposal of Excess Material
- Trade In Allowances on Purchases

Obtained Directly from FIR Reporting System

- Purchase Price Variance--Gain
- Discounts on Material Returns--Gain
- Assembly/Disassembly--Gain
- Standard Price Changes--Gain
- Physical Inventory Adjustments--Gain
- Accounting Adjustments--Gain
- Receipt of Material Returns without Credit
- Receipt of Material without Charge
- Incoming Shipments--Gain

Obtained Primarily from Monetary Reporting System but Reconciled with FIR

- Reimbursable Issues (Gross)
- Credit Allowed on Returned Material
- Material Returned Credits Received

Neither

Other Income

EXPENSE

Obtained Directly from Monetary Reporting System

Price Reductions on Sales
Discounts Lost on Purchase
Transportation Expense
Repair Expense
Trade Ins on Purchases
Allowances for Retail Stock Losses

Obtained Directly from the FIR Reporting System

Cost of Sales at Standard Price
Price Variance Distribution Account
Purchase Price Variance--Loss
Accounting Adjustments--Loss
Physical Inventory Adjustments--Loss
Standard Price Changes--Loss
Assembly/Disassembly--Loss
Discounts on Material Returns--Loss
Transfers to Property Disposal
Inventory Loss Due to Shrinkage, Theft,
Contamination, and Deterioration
Inventory Loss Due to Major Disasters
Issues without Reimbursement
Material Returns without Credit

Obtained Primarily from Monetary Reporting System but
Reconciled with FIR

Purchases at Cost
Purchases at Standard Price
Material Return Credits Applied

Neither

Other Expense

J. INCOME

The types of income statement accounts relevant to the
FIR reporting structure are the chart accounts that reflect
changes in the value of the inventory and the chart accounts

that reflect changes in the monetary value of the fund as a result of inventory transactions. Information that reflects changes in inventory value are taken directly from the compiled summary FIR report. Information that reflects changes in monetary values of the fund as a result of inventory transactions is taken primarily from the value of monetary transactions reported by the FIPC but reconciled with the compiled summary FIR report. The measure of effectiveness of the FIR in this case is the ability to transcribe information from the FIR report directly into chart of accounts format.

1. Accounts Maintained Directly from the FIR Reporting Structure

The income accounts that are accounted for directly from the FIR report are as follows:

Purchase Price Variance--Gain
Discounts on Material Returns--Gain
Assembly/Disassembly--Gain
Standard Price Changes--Gain
Physical Inventory Adjustments--Gain
Accounting Adjustments--Gain
Receipt of Material Returns without Credit
Receipt of Material without Charge
Incoming Shipments--Gain

The chart account Purchase Price Variance--Gain is maintained to show the amount determined as a gain to the value of the inventory. It is calculated by determining the difference between the standard price and the purchase price of purchased material. Price variance gains result from the

receipt of material with prices less than standard price and from differences between public vouchers and inspection reports as illustrated in Chapter 2. [Ref. 7: p. 41] The closest FIR account to chart account Purchase Price Variance--Gain is E1 (Financial Adjustments (Gains)--Purchase Price Variance) which is directly transposed to the chart of accounts. E1 is utilized to account for differences in the standard price and the purchase price, as shown on the Inspection Report, at the time material is received.

FIR account E1 is also utilized when the Inspection report is greater than the public voucher during matching, because in effect an additional purchase price variance has occurred. However, account E1 is only utilized for commercial procurement in this case and does not reflect other types of procurement price variances as a result of matching differences. These other price variances are reflected in FIR account E2 (Financial Adjustments (Gains)--Standard Price Adjustments). Since this FIR account is also utilized to reflect changes in standard price, which is reported as a separate chart account, these FIR accounts cannot be combined to reflect the true value of purchase price variance. Although this misclassification will not alter the overall value of income, because the variance is in fact recognized at some point, the true value of price variances is understated as a result. In addition, the standard price adjustment account will be overstated. A change to the

procedures that directs both commercial and other types of procurement matching differences to be reflected as price variances will permit both income statement accounts to reflect more accurate data.

The chart account Discounts on Material Returns--Gains is maintained to show the difference between the standard price of returned material and the amount of credit allowed. [Ref. 7: p. 44] The FIR account E3 (Financial Adjustments (Gains)--Discount on Material Returns) reports this value to the central accounting office. It is directly transposed from the compiled summary FIR report into chart of accounts format.

The chart account Assembly/Disassembly--Gain is maintained to account for the value of end products received from assembly, disassembly, conversion, or modification of stock fund components. In essence, it should reflect the movement of material into and out of the chart account Inventories in Process of Assembly/Disassembly as discussed in the assets section of the balance sheet. [Ref. 7: p. 47] The Navy, in fact, does utilize a FIR account that reflects gains through assembly/disassembly; FIR account E5 (Financial Adjustments (Gains)--Assembly/Disassembly). Account E5 represents gains to the inventory on hand as a result of assembly/disassembly and is directly transferable to the chart of accounts.

Standard Price Changes-Gains is a chart account that is maintained to show the increase in value of inventory on hand resulting from revisions in standard prices. [Ref. 7: p. 48] The bulk of FIR account E2 (Financial Adjustments (Gains)--Standard Price Adjustments) reflects the changes in standard price that should be reflected in the chart of accounts. However, the value of this account also includes the price variances for receipts from procurement from other than commercial sources as well as transfers from other supply officers. The exclusion of the price variances for procurements was discussed above and would also serve to purify this account. Theoretically, no variances should be involved in transfers from other supply officers because the transfer should be made at standard price. However, some means must be available to account for these infrequent occurrences and the standard price adjustment FIR accounts appear to be the most logical choice since this type of change will account for the major portion of any variances that occur in this situation.

The chart account Physical Inventory--Gain is utilized to account for the value of gains resulting from differences between physical inventories and stock records. [Ref. 7: p. 49] These transactions are reported under FIR account D4 (Inventory Adjustments (Gains)--Physical Inventory) which is directly transferable from the compiled

summary FIR report into the chart of accounts. The chart account Accounting Adjustments--Gain also has a direct counterpart that may be transcribed directly into the chart of accounts. Accounting Adjustments--Gain is maintained to account for the value of gains resulting from differences between stock record cards and ledger balances as discovered during the reconciliation process described in Chapter 2. [Ref. 7: p. 50] These transactions are reported under FIR account E4 (Financial Adjustments (Gains)--Accounting Adjustments) in the compiled summary of the FIR report.

The chart account Receipt of Material Returns without Credit reflects the value of material at standard price returned to the inventory account for which credit is not allowed. [Ref. 7: p. 51] The FIR structure reports this information under FIR account B1 (Receipts without Reimbursement--Return of Material from Users). The value of B1 contained in the compiled summary FIR report is directly transcribable to Receipts of Material without Credit.

The chart account Receipts of Material without Charge also deals with receipts to the inventory on a non reimbursable basis. However, the transposition of data from the compiled summary FIR report is slightly more complex. The purpose of the account is to reflect the value of material receipts without reimbursement. The account is to be supported by subsidiary accounts that separate the

receipts as to inter and intra service. [Ref. 7: p. 54]

The combined value of FIR accounts B2 (Receipts without Reimbursement), B3 (Receipts without Reimbursement--NSA/DLR Exchange Program), B4 (Receipts without Reimbursement--Capitalization), B5 (Receipts without Reimbursement--other), B9 (Receipt without Reimbursement--other retail activities), C1 (From Property Disposal), C2 (From Property Disposal--Reclamation), D7 (Inventory Adjustments (Gains)--Returns from Cognizance Symbol 1Q) and D8 (Inventory Adjustments (Gains)--Transfer of Clothing from Navy Exchanges) is computed from the compiled summary FIR report and transcribed to the chart account.

The various receipt without reimbursement FIR accounts that are combined into this chart account serve as the prescribed subsidiary accounts and also provide information that is utilized elsewhere within the chart of accounts. FIR Account B2 is obviously intraservice and meets the requirements for the establishment of subsidiary accounts that separate intraservice and interservice accounts. FIR Account B4 is an interservice subsidiary account that is utilized also to report the change in capital due to the capitalization of inventory as discussed in the balance sheet accounts section. Account B3 is also an interservice account that is utilized in reporting NSA/DLR material. FIR account B5 accounts for material procured outside of the military service and permits the

segregation of the remaining accounts into inter and intra service. FIR Account B9 is an additional interservice account that does not fulfill the separate reporting functions of the other interservice accounts.

The receipts from property disposal are separated according to their original source in the FIR. FIR account C1 accounts for excess material returned to inventory; FIR account C2 represents material returned to inventory after reclamation processing financed by disposal funds. Since this segregation is not required for reporting purposes, consideration should be given to the combination of these two accounts if not necessary for the implicit requirements discussed in Chapter 4. In actuality, these two FIR accounts could also be combined further with FIR account B9 in order to report all non special interservice values.

FIR Accounts D7 and D8 are utilized by the FIR structure to account for the receipt of NRSO controlled material back into the stock fund. In essence, the inventory gains are nothing more than receipts without reimbursement because the receipts represent the return of consigned material. However, the FIR is the only means available to monitor the flow of these consigned items and therefore enable the central accounting office to effect reimbursement to either NRSO or the stock fund for the differences between the return and transfer of inventory. In this case, the accounts should not be considered for combination with any

other accounts and the present procedures for compiling these values into the chart of accounts should be continued.

The chart account Incoming Shipments--Gain is maintained to account for inventory gains resulting from physical overages on shipments received. [Ref. 7: p. 55] All overages accepted by the stock fund are reported under FIR account D5 (Inventory Adjustments (Gains)--Incoming Shipment). Therefore, the value reported under D5 is directly transferable from the compiled summary FIR report into chart of accounts format.

2. Inventory Accounts Obtained from the Monetary Reporting System

The income accounts that reflect changes in the monetary accounts that result from inventory transactions and are therefore reconciled with the FIR are as follows:

Reimbursable Issues (Gross)
Credit Allowed on Material Returns
Material Return Credits Received

The chart account Reimbursable Issues (Gross) is maintained to reflect the value, at full standard price, of inventories sold or issued with reimbursement. This account must be supported by subsidiary accounts in which details of all reimbursable issues are broken down by appropriation, fund and type of customer. [Ref. 7: p. 38] Reimbursable issues reflect the amount of cash received by the stock fund for sales or reimbursable issues from inventory. This cash value is reported to the central accounting office via the

monetary accounting system. The value of each transaction contains all the information available for the maintenance of the required subsidiary accounts.

The resultant decreases in inventory, as a result of the sale or issue, are reported as expenses by the FIR reporting structure. Theoretically, the value of these two types of chart accounts should be equal. However, due to timing differences, this is rarely the case and is responsible for a major portion of the difference closed to operating results. The value of this difference can be obtained by reconciliation of the information provided by both reporting systems. For reconciliation purposes, the FIR structure is designed to allow inventory information to be maintained in the same subsidiary accounting structure. This structure will be analyzed in a later section when the chart accounts reflecting these decreases in inventory are discussed in the Expense Section.

The chart account Credit Allowed on Material Returns is maintained to reflect the amount of credit allowed to customers for the return of material to inventory. In actuality, this account represents the gain to the inventory as a result of returned material for which credit is allowed. However, this account also has an effect on the monetary accounts because the value within this account must agree with the value in chart account Material Return Credits Applied included in the Expense Section. This

account reflects the decrease in the monetary accounts for the credits granted for the returned material. In essence, income is recognized for the portion of inventory increase associated with returns with allowed credit. Expenses are recognized for the payment of the credit from the monetary account. [Ref. 7: p. 42] Therefore, it is necessary to reconcile the values reported by both the monetary and inventory reporting systems. The compilation of FIR accounts J2 (Issues with Reimbursement--Returns--Service use) and J4 (Issues with Reimbursement--Returns--other than Service use and MAPS) from the compiled summary FIR report provides the central accounting office with the value of credits allowed in material returns.

The establishment of two separate accounts, as discussed above, reports the value of material returns in accordance with their manner of issue. Although detailed information on customer types is required for the issue of material, this information is not required for material returns. Therefore, unless this level of detail is necessary to fulfill the implicit requirements discussed in Chapter 4, the combination of these two FIR accounts would appear to be a distinct possibility. This would be extremely helpful because accounting for material returns is one of the most complex areas of the FIR structure as discussed in Chapter 2.

The chart account Material Return Credits Received is maintained to account for the value of credits received by the stock fund for returned material as reflected in billing documents or cash refunds received. [Ref. 7: p. 46] Therefore, the primary source of information for the maintenance of this account is derived from the monetary reporting system. However, transaction data reported in the compiled summary FIR report also reflects this information through a compilation of FIR accounts A2 (Receipts from Procurement--Material Returns--Commercial), A4 (Receipts from Procurement--Material Returns--other DOD agencies), and A6 (Receipts from Procurement--Material Returns--other). Although source of procurement information is required by the chart of accounts for receipts from procurement, it is not necessary for material returns. Therefore, unless this level of detail is necessary for the implicit requirements discussed in Chapter 4, the combination of these three FIR accounts would also appear to be a distinct possibility.

K. EXPENSE

As was the case with the Income section, the only Expense accounts relevant to the discussion of the FIR structure are those that either reflect changes in the value of the inventory or those that reflect changes in the monetary accounts as a result of inventory transactions. These

accounts are either directly obtained from the FIR or primarily obtained from the monetary reporting system but reconciled with the FIR. The sections below discuss these types of transactions as they pertain to the FIR reporting structure.

1. Accounts Maintained Directly from the FIR Reporting Structure

The expense accounts that are maintained directly from the FIR report are as follows:

- Cost of Sales at Standard Price
- Purchase Price Variance-Loss
- Accounting Adjustments-Loss
- Standard Price Changes-Loss
- Physical Inventory Adjustment-Loss
- Assembly/Disassembly-Loss
- Transfers to Property Disposal
- Inventory Loss due to Shrinkage, Theft, Contamination,
and Deterioration
- Inventory Loss due to Major Disasters
- Issues without Reimbursement
- Material Returns without Credit
- Incoming Shipments-Loss
- Discount on Material Returns-Loss

The chart account Cost of Sales at Standard Price is maintained to reflect the value of inventory reductions as a result of issues with reimbursement. [Ref. 7: p. 58]

Theoretically, the value contained in this expense account should be equal in value to the amount carried in the income account Reimbursable Issues (Gross). In essence, the two accounts simply represent the change in the composition of the asset holdings of the fund. The income account represents an increase to cash accounts receivable while the

expense account represents the decrease to inventory. However, the real world is rarely as simple as theory and differences usually occur between the two accounts due to timing experienced by the two reporting systems. In this case, differences will occur between the two accounts that will affect the value of the fund throughout the fiscal year. These differences will be part of the value closed to operating results at the end of each accounting period. Special year end procedures, which utilize transaction date cutoffs, are used to ensure that the two accounts are brought into balance prior to the closing of the accounts and the submission of required reports. The compilation of FIR accounts J1 (Issues with Reimbursement--Service use), J3 (Issues with Reimbursement--other than service use and MAPS), and J5 (Issues with Reimbursement--MAPS) from the compiled summary FIR report can be directly transcribed to the chart account Cost of Sales at Standard Price.

The separation of Issues with Reimbursement by the FIR accounting structure is an attempt to report inventory expense information in the same subsidiary accounting structure utilized for monetary income reporting. However, the expense account Cost of Sales at Standard Price does not require this subsidiary information. Since reconciliation between the two reporting structures can be conducted on total values, it does not appear necessary to report inventory information at this level of detail required for

reporting purposes. The combination of these three FIR accounts appears to be a distinct possibility unless required for the implicit requirements discussed in Chapter 4.

The chart account Purchase Price Variance--Loss is maintained to show the value of differences between the standard cost and the purchase price of the material. It is similar to the chart account Purchase Price Variance--Gain and is used when the opposite situation occurs (i.e. the purchase price is greater than the standard cost).

[Ref. 7: p. 62] The loss account is by far the most prevalent of the two over the accounting period because prices will tend to rise rather than fall after the standard price is established. However, because the standard price includes added surcharges, the "gain" account will be prevalent around the establishment of a new standard price. FIR account N1 (Financial Adjustments (Losses)--Purchase Variance) is transcribed directly to the chart account Purchase Price Variance--Loss.

Although FIR account N1 does in fact record the value of price variances, its value is incomplete in the same manner described for purchase price gains under the income section. When public vouchers are found to be greater than inspection reports during matching, an additional price variance loss has occurred and must be recorded. For commercial procurements, this is in fact the

case. However, other procurement matching discrepancies are reported under FIR account N2 (Financial Adjustment (Losses)--Standard Price Adjustments). Since this value is transcribed to chart account Standard Price Changes--Loss both expense accounts will be misstated. However, the total value of expenses will be maintained correctly because the adjustment is still reflected at some point within the accounts. Therefore, a procedural change that requires all purchase price variances to be maintained as price variances, would reflect more accurate data in both accounts.

The chart account Price Variance Distribution Account is utilized to close the price variance accounts (both gains and losses) and distribute the total variance to appropriate accounts. [Ref. 7: pp. 60-61] In this regard, it can be considered as receiving its information from the FIR reporting structure because the chart accounts it utilizes receive their information from the FIR. However, it should be remembered that the account is merely a distribution account and in essence does not reflect either an income or an expense.

The chart account Accounting Adjustments-Loss is designed to reflect the value of losses resulting from differences between stock records and financial records as discovered during the reconciliation discussed in Chapter 2. [Ref. 7: p. 63] The value of losses as a result of this reconciliation is reported to the central accounting office

by FIR account N4 (Financial Adjustments (Losses)--Accounting Adjustments). Therefore, the value of FIR account N4 may be directly transcribed from the compiled summary FIR report into chart of accounts format.

The chart account Standard Price Changes--Loss is similar in all respects to the income account that reports gains under the same title. It is utilized to report losses that result from revisions of standard price. [Ref. 7: p. 65] FIR account N2 (Financial Adjustments (Losses)--Standard Price Adjustments) includes the value of losses in this category and is presently transcribed directly to Standard Price Changes--Loss. However, the FIR account also includes price variances from procurement from sources other than commercial. Therefore, this FIR account should be purged of any price variances, similar to the description in the Income Section, if it is to reflect the true value of standard price changes.

The chart account Physical Inventory Adjustments--Loss reflects the value of losses as a result of differences between stock records and physical inventory quantities. [Ref. 7: p. 64] FIR account M4 (Inventory Adjustments (Losses)--Physical Inventory) is utilized to report the value of physical inventory losses to the central accounting office. Therefore, the value contained in account M4 of the compiled summary FIR report is directly transcribed to chart of accounts format.

The chart account Assembly/Disassembly--Loss is utilized to show the value of stock fund material used in assembly, disassembly, conversion, or modification of stock fund end products. Similar to the gain account described in the income section, the account is designed to reflect the movement of material into and out of the chart account Inventories in Process of Assembly/Disassembly contained in the balance sheet. [Ref. 7: p. 66] FIR account N5 (Financial Adjustments (Losses)--Assembly/Disassembly) reflects the decreases to the value of inventory on hand as a result of transfer to the balance sheet account and may therefore be directly transcribed to chart of accounts format.

Transfers to Property Disposal is a chart account maintained to reflect the value of excess and surplus material transferred to property disposal offices for disposal action. [Ref. 7: p. 69] Transfers to property disposal are reflected in two FIR accounts; L1 (Transfers to Property Disposal) and L2 (Transfers to Property Disposal--Reclamation). The first account is utilized to account for direct transfers to disposal activities for disposition, the second account reflects the value of material transferred that will be subjected to reclamation processing with disposal funds and subsequently returned to inventory. For reporting purposes, the two accounts are combined from the compiled summary FIR report and transcribed to the chart of accounts. The separation of the two accounts advises the

inventory manager of future receipts which can be utilized when planning future procurement requirements. Since this information is already available to the inventory manager through stock record reports, the two accounts should be considered for combination if not required for the implicit requirements discussed in Chapter 4.

The chart accounts Inventory Loss Due to Shrinkage, Theft, Contamination, and Deterioration and Inventory Loss Due to Major Disasters are utilized to account for losses due to extraordinary means as described by their titles. [Ref. 7: pp. 74-75] The inventory reporting structure utilizes FIR accounts to report inventory losses according to the same categories; FIR account M6 (Inventory Adjustments (Losses)--Shrinkage, Theft, etc.) and M7 (Inventory Adjustments (Losses)--Major Disaster Losses). The value of these accounts contained in the compiled summary FIR report are directly transcribed into chart of accounts format.

The chart account Issues without Reimbursement is maintained to reflect the value of material issued without reimbursement. This account must be supported by subsidiary accounts that separate these types of issues into interservice transfers, intraservice transfers, and transfers to MAPS. [Ref. 7: p. 77] In order to obtain the total that should be included in this account, the following FIR accounts are compiled from the compiled summary FIR report; K1 (Issues without Reimbursement--Service use), K3 (Issues

without Reimbursement--Intraservice), K5 (Issues without Reimbursement--Decapitalization), K6 (Issues without Reimbursement--MAP--Grant Aid), K8 (Issues without Reimbursement--other), K9 (Issues without Reimbursement--other Retail Activities), KB (Issues without Reimbursement--Retail to Wholesale Activity), MA (Inventory Adjustments (Reductions)--Transfers to Cognizance Symbol 1Q) and MB (Inventory Adjustment (Reductions)--Transfers of Clothing to Navy Exchange).

FIR Accounts K1, K3 and K6 are utilized to separate the issues without reimbursement in accordance with the separation requirements contained in the chart of accounts. FIR Account K5 is an interservice account that identifies the value of this type of issue that took place due to decapitalization. Since this information is required by the chart of accounts in the balance sheet, this account must no doubt stand alone. Accounts K8, K9, and KB are interservice accounts that report special issue categories. Since these categories are not required for reporting purposes, they should be considered for combination with account K1 if not required for the implicit purposes discussed in Chapter 4. Account MA and MB report issues of material on consignment to NRSO control as discussed in the Income Section for the return of consigned material. Although they are compiled into issues for reporting purposes, segregation of these

accounts is necessary in order to effect reimbursement between NRSO and the stock fund as previously discussed.

The chart account Material Returns without Credit is maintained to show the value of material returned by the stock fund for which credit is not allowed. [Ref. 7: p. 78] FIR account K7 (Issues without Reimbursement--Material Returns) from the compiled summary FIR report is transcribed directly into chart of accounts format. K7 represents the value of returned material to other stock funds for which credit is not allowed, therefore, it would appear that no discrepancies exist as to material returns without credit. However, close examination of the procedures for returned material, as discussed in Chapter 2, indicates a slight problem in representation of the values contained within this account and the chart account entitled Issues without Reimbursement. When material was originally received under FIR account A5 (Receipts from Procurement--other) the value of returned material without reimbursement is included in FIR account K8 (Issues without Reimbursement--Other). The effect of this procedure is to report this classification of material return as an issue without reimbursement. Therefore, the procedures should be changed to include all values of material returns without credit in FIR account K7. This would correctly reflect the proper amount in each expense account.

The chart account Incoming Shipments--Loss is maintained to show the value of inventory losses resulting from physical shortages in shipments received. [Ref. 7: p. 80] The procedures utilized by the FIR structure to account for material shortages from receipt of shipment are illustrated in Figure 2.10. Shortages are accounted for in three ways according to dollar value and carrier liability; 1. as inventory losses, which is the most prevalent, 2. as issues with reimbursement, and 3. as decreases in Receipts from procurement. The latter categories are utilized when shortages are not accounted for as shortages but adjustments are made to the stock fund from a monetary basis. FIR account M5 (Inventory Adjustments (Losses)--Incoming Shipment) reports the value of shortages actually accounted for as inventory adjustments and can be directly transcribed into chart of accounts format.

The chart account Discounts on Material Returns--Loss reflects the difference between the standard price of material and the amount of credit received by the stock fund for returned material. [Ref. 7: p. 68] The FIR account N3 (Financial Adjustments (Losses)--Discounts on Material Returns) reports this value to the central accounting office. It is directly transcribed from the compiled summary FIR report into chart of accounts format.

2. Inventory Accounts Obtained from the Monetary Reporting System

The expense accounts that reflect changes in the monetary accounts that result from inventory transactions are as follows:

- Purchases at Cost
- Purchases at Standard Price
- Material Returned for Credit
- Material Return Credits Applied

The chart account Purchases at Cost accounts for the value of receipts, at cost price, for all receipts from procurement. The account must be supported by subsidiary accounts which detail purchases by individual procurement source.

[Ref. 7: p. 57] The chart account Purchases at Standard Price is maintained to show the value of receipts of material at standard price. [Ref. 7: p. 58] The combination of the accounts, in effect, reports the amount of cash spent during the accounting period for replenishment of inventory items. The values for the maintenance of this account comes from copies of the abstracted public vouchers provided to the central accounting office by the monetary reporting system. This information is then reconciled with the receipt information contained within the FIR structure. The difference between the two systems is regarded as material in transit as discussed previously. The value of receipts at purchase costs is provided by FIR account A1 (Receipts from Procurement--Commercial). The value of receipts at standard price

is provided by a compilation of FIR accounts A3 (Receipts from Procurement--other DOD agencies) and A5 (Receipts from Procurement--other). The separation of the accounts is an attempt to provide the same subsidiary level of data from the inventory system that is required of the monetary system. Since the required level of detail is maintained by the monetary system and reconciliation is still possible at the total level, combination of these three accounts into two accounts appears to be a possibility. It should be considered if the implicit requirements, discussed in Chapter 4, do not indicate another reason for their segregation.

The chart account Material Returned for Credit reflects the value of material returned for which credit is granted. [Ref. 7: p. 70] In actuality, it is the expense side of the discussion concerning the chart account Material Return Credits Received. Therefore the analysis contained in that section also applies in this case.

The chart account Material Return Credits Applied is maintained to account for the value of credits applied to customer accounts receivable as a result of returned material. It is a monetary account that reflects the cash expense for the credit account and receives its information totally from the monetary reporting system. [Ref. 7: p. 73] However, as discussed in the Income section, the balance in this account must be in agreement with the chart account Credit Allowed on Material Returns.

L. SUMMARY OF INCOME STATEMENT CONCLUSIONS

Analysis of the Income Statement Accounts provide insight into a number of areas where the FIR reporting structure could be simplified through revision and modification. First of all, nowhere is the complex level of detail at which the inventory accounts are maintained utilized. Since this was also true for the Balance Sheet Accounts, it would appear that the FIR structure could be maintained at the cognizance symbol level.

Second, the detailed information provided by the FIR coding structure is not necessary in many places. Information contained within the monetary reporting system and the stock record management system is merely duplicated by the FIR structure. At the present time 9 different FIR accounts are utilized to provide subsidiary information for receipts without charge. In many cases, the accounts go beyond the required subsidiary structure and provide management data that is available elsewhere. These 9 accounts could be reduced to 7 and still provide the level of detail prescribed by the chart of accounts.

Receipt and issue of reimbursable material is accounted for through the monetary reporting system and reconciled with inventory values as described above. In both cases, detailed subsidiary accounts are maintained at the inventory level which simply duplicates the information provided by the monetary reporting system. The same is true for

material returns in both categories. Combination of the receipts from procurement section would reduce the present 6 FIR accounts to 2. Combination of the issues with reimbursement section would reduce the 5 FIR accounts presently in use to 2.

Issues without Reimbursement are maintained at a level which not only provides the required subsidiary structure but also detailed management information available through the stock record management system. At the present time 9 FIR accounts are utilized to report issues without reimbursement. Combination of these accounts would leave 6 accounts that would meet all the requirements prescribed by the chart of accounts.

Third, information provided by the FIR reporting structure does not reflect the true form prescribed by the chart of accounts. This is most prevalent in the discrepancies concerning price variances and standard price adjustments. In these cases, procedural changes are required that will reflect the prescribed form of information.

M. REPORTING REQUIREMENTS

The information contained within the chart of accounts is utilized by the central accounting office in the preparation and submission of financial statements to the Congress and other Government Agencies. There are 9 financial statements prescribed by DOD INST 7420.11.

1. Statement of Financial Condition
2. Changes in Capital of the Fund
3. Summary of Cash Sources and Application
- 3A. Financial Program Objectives
4. Changes in Inventory Statement
- 4A. Inventory Status and Transaction Statement
5. Operating Budget Statement
6. Reimbursable Issues
7. Monthly Management Report

Statements 3A, 4A, 5, and 6 are submitted with annual budget estimates and for apportionment and reapportionment requests. Statements 1, 2, 3A, 4, 4A, and 6 are submitted semiannually. Statement 3 is submitted annually and statement 7 is submitted monthly. [Ref. 7: pp. 2-4] The amounts reported in statements 1 and 2 are reported to the nearest dollar; statements 3, 3A, 4, 4A, 6, and 7 are reported to the nearest thousand dollars.

Once information is transposed from the reporting structures into chart of accounts format, it is in the form necessary for preparation of the required reports. The chart of accounts is simply transcribed into the format designed for each financial statement. Therefore, the analysis above also measures the effectiveness of the FIR reporting structure in fulfilling the external reporting requirements of the stock fund. No further analysis is therefore necessary. However, the format of the reports are presented in Figures 3.3 through 3.11 for the sake of continuity in understanding how the information within the chart of accounts is utilized. Detailed instructions on the transposition of the

data from the chart of accounts into the financial statements are contained in DOD INST 7420.11.

The information contained in the Statement of Changes in Financial Condition, the Summary of Cash Sources and Application, the Financial Program Objectives and the Operating Budget Statement is reported for the current fiscal year as well as the budget year. Information in the Statement of Changes in capital is provided for the current accounting period and cumulative year to date. The changes in Inventory Statement and the Inventory Status and Transaction Statement report total values. In addition, the Transaction Statement reports totals according to the status of inventory such as "on hand," "in transit," etc. The reimbursable Issues Statement and the Monthly Management Report reports values for the current fiscal year.

Assets

1. Cash:
 - a. Available for Disbursement
 - b. Unallocated reserve
 - c. Total available Treasury balance
2. Accounts Receivable:
 - a. U.S. Government agencies
 - b. Other
 - c. Total accounts receivable
3. Inventories of material
4. Undelivered purchases-capitalized contracts
5. Progress payments
6. Advance payments
7. Undistributed collections
8. Other assets
9. Total assets

Figure 3.3 Statement of Financial Condition

LIABILITIES

10. Accounts payable:
 - a. U.S. Government agencies
 - b. Other
 - c. Total accounts payable
11. Undistributed disbursements
12. Other liabilities
13. Total liabilities and capital
14. Capital of the Fund
15. Total liabilities and capital
16. Data on obligational authority:
 - a. Contracts and orders outstanding
 - b. Commitments outstanding
 - c. Balance of budget authority for commitment

Figure 3.3 Contd.

1. Total Capital at beginning of period
2. Changes in cash capital:
 - a. Direct appropriations
 - b. Cash Allocations
 - c. Cash Transfers to U.S. Treasury
 - d. Cash Transfers to appropriation (net)
 - e. Total
3. Changes in inventories capitalized:
 - a. Capitalized inventories
 - b. Capitalized undelivered purchases
 - c. Stock withdrawal credits
 - d. Inventories decapitalized
 - e. Total
4. Changes in capitalized assets and liabilities (other than inventories)
 - a. Other assets capitalized/decapitalized
 - b. Other liabilities capitalized/decapitalized
 - c. Total
5. Operating changes in capital:
 - a. Standard price changes (net)
 - b. Purchase price variance (net)
 - c. Surcharge for inventory losses
 - d. Surcharge for transportation

Figure 3.4 Changes in Capital of the Fund

- e. Allowances granted for stock losses
 - f. Discounts on material returns (gain)
 - g. Receipts of material return without credit (gain)
 - h. Inventory loss on material returns
 - i. Material returns for credit
 - j. Material returns without credit (loss)
 - k. Trade-ins on purchases
 - l. Receipts of material without charge
 - m. Issues without Reimbursement
 - n. Transfers to property disposal offices
 - o. Proceeds from disposal of excess material
 - p. Inventory losses and adjustments
 - q. Price reductions on sale
 - r. Transportation expense
 - s. Repair expense
 - t. Miscellaneous (net)
 - u. Total
- 6. Total changes in Capital during period
 - 7. Total Capital at end of period

Figure 3.4 Contd.

APPROPRIATIONS

- 1. Cash provided by:
 - a. Direct appropriations and transfers from appropriations
 - b. Cash allocations
 - c. Total cash provided
- 2. Cash applied to:
 - a. Cash transfers to U.S. Treasury or appropriations
 - b. Cash returned to unallocated reserve
 - c. Total cash applied
- 3. Cash provided less cash applied

OPERATIONS

- 4. Cash provided by revenues:
 - a. Reimbursable issues (net)
 - b. Proceeds from disposal of excess material
 - c. Miscellaneous

Figure 3.5 Summary of Cash Sources and Application

- d. Total accrued revenues
- e. Accounts receivable decrease
(+) or increase (-)
- f. Reserve for equity of others
- g. Other assets
- h. Undistributed collections/disbursements
- i. Total cash provided
- 5. Cash applied to Expenditures:
 - a. Purchases at cost
 - b. Transportation expense
 - c. Repair expense
 - d. Miscellaneous
 - e. Total accrued expenditures
 - f. Accounts payable decrease
(+) or increase (-)
 - g. Other liabilities decrease
(+) or increase (-)
 - h. Progress payments and advance payments
increase (+) or decrease (-)
 - i. Undistributed disbursements/collections
 - j. Total cash applied
- 6. Cash provided less cash applied
- 7. Net change-increase (+) or decrease (-)
- 8. Available U.S. Treasury balance at beginning
of period
- 9. Available U.S. Treasury balance at end of period

Figure 3.5 Contd.

- 1. Reimbursable Issues
- 2. Total Demands
- 3. Receipts from Procurement
- 4. Obligations
 - a. Peacetime
 - b. Provisioning
 - c. Mobilization
- 5. Net Investment Chg.
(line 4-1)
- 6. Disbursements
- 7. Collections
- 8. Net Expenditures (line 6-7)
- 9. Cash Balance
- 10. Unpaid Obligations
- 11. Accounts payable

Figure 3.6 Financial Program Objectives

12. Accounts receivable
13. Unoblig. Commitments
14. Backorders
15. Inventories
16. On-order

Figure 3.6 Contd.

1. Total Inventories beginning of period
- CHANGES DURING PERIOD
2. Receipts from Procurement at cost
 3. Discounts on Purchases
 4. Allowances received for stock issues
 5. Material return credits received from suppliers
 6. Trade-in allowances on purchase
 7. Capitalized undelivered purchases
 8. Total receipts of cost price
 9. Surcharge for transportation
 10. Surcharge for stock losses
 11. Purchase price variance (net)
 12. Total receipts at standard price
 13. Reimbursable issues (net)
 14. Price reductions on sales
 15. Allowances granted for stock issues
 16. Material return credits applied
 17. Issues against withdrawal credits
 18. Total gross sales
 19. Material returns from customers for credit
 20. Material returns from customers without credit
 21. Material returns to suppliers for credit
 22. Material returns to suppliers without credit
 23. Inventories capitalized
 24. Inventories decapitalized
 25. Standard price changes
 26. Receipts of material without charge:
 - a. Interservice
 - b. Intraservice
 27. Issues without reimbursement:
 - a. Interservice
 - b. Intraservice
 - c. MAP

Figure 3.7 Changes in Inventory Statement

28. Transfers to property disposal offices
29. Trade-ins on purchases
30. Inventory losses and adjustments:
 - a. Losses due to major disasters
 - b. Losses due to shrinkage, theft, etc.
 - c. Physical inventory adjustments (net)
 - d. Accounting adjustments (net)
 - e. Gain/Loss on incoming shipments
 - f. Gain/Loss on assembly/disassembly
31. Material transfers between strata
32. Total changes for the period
33. Total inventories end of period

Figure 3.7 Contd.

1. Inventories end of previous period
2. Reclassification based on strata
3. Stratified inventories beginning of period
4. Receipts at standard price
5. Gross sales
6. Inventory increases and decreases during period
 - a. Capitalized inventories
 - b. Material returns from customers for credit
 - c. Material returns without credit and receipts of material without charge
 - d. Standard price changes (net)
 - e. Transfers to property disposal offices
 - f. Issues without reimbursement
 - g. Inventories decapitalized
 - h. Other gains and losses
 - i. Transfers between strata
7. Total inventories end of period

Figure 3.8 Inventory Status and Transaction Statement

MATERIAL REQUIREMENTS

1. Inventory acquisition and on-order objectives end of period
 - a. Peacetime asset objective
 - b. Total mobilization acquisition
 - c. Less: Balance mobilization requirement

Figure 3.9 Operating Budget Statement

- d. Mobilization acquisition protectable
- e. Total objective (a & d)
- 2. Material usage:
 - a. Reimbursable issues (net)
 - b. Sales credits and allowances
 - c. Total issues
- 3. Total material requirements
- LESS MATERIAL AVAILABILITY
- 4. Inventories applicable at beginning of period
 - a. Peacetime stock
 - b. Mobilization acquisition-protectable
 - c. In-transit and other stocks
- 5. Inventory increases and decreases during period applicable
- 6. Total inventories applicable
- 7. Net requirements at standard price
 - a. Less credits, allowances on purchases and receipts under capitalized contracts
 - b. Less unfunded requirements
- 8. Net funded requirements at standard price
 - a. Less surcharges and purchase variances
- 9. Requirements at cost
- 10. Material on order:
 - a. End of period (memo)
 - b. Beginning of period-applicable (-)
 - c. Beginning of period-inapplicable (memo)
- 11. Total procurement requirement
- 12. Add other obligation requirements:
 - a. Transportation costs
 - b. Repair costs
 - c. Other costs
 - d. Contracts and Orders outstanding for repair of stocks, increase (+) or decrease (-)
 - e. Total other obligation requirements
- 13. Total fiscal year procurement requirement
- 14. Less commitments at cost-end of period
- 15. Total peacetime obligation requirement
- 16. Balance mobilization reserve requirement:
 - a. Requirement
 - b. Assets
 - c. Net requirement at standard price
 - d. Net requirement at cost price
 - e. Funds requested
- 17. Total fiscal year obligations

Figure 3.9 Contd.

CUSTOMER

1. This department: Fund or appropriation
2. Other agencies of Department of Defense
3. Other U.S. Government agencies
4. Foreign Military Sales (FMS)
5. All other
6. Total reimbursable issues (net)
7. Add sales credits and allowances:
 - a. Material return credits applied
 - b. Allowances granted for stock losses
 - c. Price reductions on sales
 - d. Issues against stock withdrawal credits
8. Total gross sales

Figure 3.10 Reimbursable Issues

- A. Demands-Cumulative
- B. Gross Issues-Cumulative
- C. Unfilled Customer Orders on Hand
- D. Material Return Credits Applied-Cumulative
- E. Net Reimbursable Issues-Cumulative
- F. Purchases at Cost-Cumulative
- G. Purchases at Standard-Cumulative
- H. Obligations-Cumulative
- I. Obligations Replenishment-Cumulative
- J. Obligations Provisioning-Cumulative
- K. Obligations Mobilization Reserve-Cumulative
- L. Unobligated Commitments
- M. Inventories-Stock on Hand
- N. Other inventories
- P. Inventories in Transit
- Q. Total inventories
- R. Material returned from customers without credit Cumulative
- S. Transfers to Property Disposal offices (PDO's)-Cumulative
- T. Material returns to suppliers-cumulative
- U. Material on Order from Procurement
- V. Cash on hand
- W. Collections-Cumulative
- X. Disbursements-Cumulative
- Y. Accounts Receivable
- Z. Accounts payable

Figure 3.11 Monthly Management Report

N. CHAPTER SUMMARY

The present FIR structure theoretically meets or exceeds its governing regulations for the maintenance of inventory information for the stock fund. In a few minor instances information is misrepresented, but not to any great degree; especially when one considers that most reports are prepared to the nearest thousand dollars and the discrepancies of this type will concern small dollar values. However, the present FIR structure contains a complex coding system, which destroys a significant portion of the systems ability to report information in an accurate and timely manner. This becomes evident in the number of discrepancies noted by the audit service in financially suspended transactions, reconciliation of stock record and financial data, and the general accuracy of information reported by the FIR structure.

The focus of this chapter has been to analyze the governing regulations of financial inventory reporting, determine how the FIR structure fulfills its requirement to meet these regulations, and explore possible means that could be utilized to simplify the system while continuing to fulfill its legal obligations. A number of possibilities were discussed that would greatly reduce the coding structure of the FIR reports, the most important of which was the concept of maintaining inventory information at the cognizance symbol level. However, before specific alterations can be made to the FIR structure, it is first necessary to

determine the detail of information needed in order to fulfill the implicit requirements of the system. These requirements will be the subject of the analysis presented in Chapter 4.

IV. THE IMPLICIT REQUIREMENTS

A. BACKGROUND

The design effectiveness of any accounting system is measured by its ability to meet both the external reporting and internal management requirements of the organization. The analysis contained in Chapter 3 focused on how the FIR reporting structure is utilized by the central accounting office to fulfill the external reporting requirements of the stock fund; by meeting the requirements of DOD INST 7420.11. It must be remembered that the FIR reporting structure is only one aspect of a rather complex decentralized accounting system. Inventory information is maintained at the activity level and reported to the central accounting office. Monetary information is maintained by the Financial Information Processing Center, at another location, and reported to the central accounting office. The information reported by these two systems is reconciled by the matching procedures discussed in Chapter 2.

However, external reporting is only half of the picture when determining the total effectiveness of an accounting system. In addition, accounting systems must be able to provide internal management with information necessary to operate the organization in an effective manner. In this case, the internal management information is provided to

various inventory managers and the central accounting office for use in managing the inventory account (i.e. NSA, APA, etc.). This internal management information can be viewed as the implicit requirements of the accounting system. The implicit requirements of the FIR structure can be segregated into two distinct categories;

1. the ability to ensure the integrity of and provide financial safeguards over material inventories
2. the ability to furnish inventory managers with essential financial data for budgetary requirements.

The ability to ensure the integrity of material in inventory through financial safeguards essentially translates into the ability to reconcile the values maintained by the FIR structure and the values maintained by the stock record inventory maintenance system. Therefore it is necessary to conduct a reconciliation between the two systems at the end of each accounting period. This reconciliation process is an internal process accomplished after the system has concluded all external reconciliation as discussed above. In essence, the matching procedures are first accomplished through external sources in order to ensure the integrity of the FIR with the monetary reporting system. Once this is accomplished, the FIR is then reconciled internally with information maintained by the stock record maintenance system. This ensures that the FIR agrees with the value of inventory maintained by the warehouse and serves as a check

on the integrity of the entire system. The ability to conduct such a reconciliation is dependent upon two distinct factors;

1. the bottom line values of each system should be expressed in the same general terms
2. the systems should be designed in such a manner that it is possible to accurately identify differences that surface during the reconciliation process.

As discussed in Chapter 2, this reconciliation process is presently experiencing a number of difficulties under the present FIR structure.

The FIR structure is also responsible for providing inventory managers with essential financial data for budgetary requirements. Essentially, data from the FIR is used for budget purposes in two ways. First, the data reported by the FIR is used to compare actual performance with the original budget submission. This means that the data contained in the reporting structure must be easily converted to the format of the original budget submission for comparison. Second, the historical data is analyzed and used as a base for projecting future budget submissions. Here again the data must be easily converted into budget submission format.

This chapter reviews how the present FIR structure is utilized to fulfill these implicit requirements necessary for internal management control. In addition, an attempt is made to specifically identify the level and content of

information necessary for the system to effectively fulfill these requirements. Conclusions and recommendations are then presented which could permit system simplification while maintaining the same level of effectiveness. These recommendations and those contained in Chapter 3 will be compared and summarized in Chapter 5 where a brief outline of a revised FIR structure will be presented for possible adoption.

B. INTEGRITY AND FINANCIAL SAFEGUARDS OVER INVENTORIES

1. General

This requirement of the FIR structure is the most difficult to analyze because of the lack of any published documentation by higher authority on just what the maintenance of integrity means. The topic is therefore quite nebulous and open to many different interpretations. For the purposes of this thesis integrity will be interpreted as the ability to maintain a system of checks and balances with the stock record maintenance system through the reconciliation process. If one simply looks at the ability of the present FIR structure to undergo the reconciliation process with the stock record maintenance system, then the logical conclusion is that the present structure is extremely capable of fulfilling this requirement. Theoretically, this is in fact so. However, actual practice is rarely as simple as theory and the reconciliation process is indeed an

excellent example of how theory and practice can be at two different ends of the spectrum. The problems identified by the Naval Audit Service clearly point this out. If the system is functioning properly, then discrepancies between the two inventory monitoring systems should be relatively small, easily identified, and accurately corrected in a timely manner. Instead, the audit service found that the reconciliation process was so replete with errors as to be almost a meaningless paperwork drill. Adjustments amounted to approximately 100% of the value of transactions to inventory. Accurate data on the value of these differences was not always available. In addition, when differences were identified, the activity was not always able to identify correctly where and why these differences occurred. This happened in approximately 38% of all reconcilable differences. Although the system is designed to absorb a certain amount of these type of adjustments (utilizing the FIR coded Accounting Adjustments account) 38% is a relatively high figure. In addition, this situation is further compounded by financially suspended transactions which are included in the FIR structure. [Ref. 6: pp. 4-5] This type of transaction, no doubt, is responsible for a large portion of the unreconciled differences that appear. The conclusion then, based upon the findings of the audit report, must be that the present FIR structure is not always able to fulfill its integrity requirement in an effective manner.

Essentially, four distinct problems were noted by the audit service;

1. the type of adjustment required is often misstated
2. the adjustments actually made are often invalid
3. FIR coding is often misstated making it extremely difficult to reconcile accounts
4. it is often simply impossible to reconcile the differences that exist.

It would therefore appear logical to explore the reasons for the existence of these problem areas prior to making any recommendations for modification of the present system. However, one must first understand the reconciliation process, which is the subject of the next section.

2. Reconciliation of Stock Records and the FIR

The first step in the reconciliation process is to compare the bottom line values of each category of material. This is possible since the value of material is maintained within each system at standard price. A summary of the value of inventory as contained in the stock records is provided to the accounting department in the same levels as the FIR report (i.e. inventory account, cognizance symbol, and material control code/condition code combination). When the closing balances of each system are in agreement, no further processing is required and that category is considered reconciled. When differences occur, the activity must attempt to identify the reasons for these differences and adjust the out of balance system accordingly, in order

to bring the two systems into agreement. In practically all cases it is assumed that the information contained within the FIR is out of balance. This would seem logical since the stock records reflect the value of actual stock on hand.

The next step is to identify the value of differences occurring by transaction type. This information is available from the stock record maintenance system but not in the same detail and format as presented by the FIR structure. The transaction totals available from the stock records are receipts, issues, and money value only adjustments. Therefore, the various FIR coded subsidiary accounts must be compiled into this format prior to comparison with the values contained in the stock record summary. This requires that all FIR transactions that represent receipts to the stock records be combined into one total for comparative purposes. This includes all receipt accounts regardless of reimbursement status, all contra issue accounts, and all gains as a result of inventory adjustments. Issues to the stock records are reflected in the compilation of all issue accounts, contra receipt accounts, and losses as a result of inventory adjustments. The money value only transactions will be reflected in the value of financial adjustments reported by the FIR structure.

Once the FIR accounts are compiled in the manner described above, the values are compared with the values contained in the stock record summary. This process should

isolate the type or types of transactions that are out of balance. Once the transaction type is identified, the process of identifying reasons for the occurrence of differences begins. A detailed transaction listing from the stock record summary is compared with the entries made in the FIR accounts pertaining to that type of transaction. For example, suppose receipts were isolated as being out of balance. The entries in each FIR account reflecting receipts to inventory would be compared with the transaction listing of receipts from the stock records. Entries that are not reconcilable to an entry on the stock record summary are identified for further processing. At the end of this process any entries remaining on the stock record transaction listing that have not been reconciled with FIR account entries are also identified for further processing.

At this point in the process the activity will have identified one or both of the following reasons for the imbalance: 1. entries recorded in the FIR accounts that are not reflected on the stock records and 2. entries recorded on the stock records that are not reflected in the FIR account. The reasons for these differences are then identified and the out of balance system (usually the FIR) is adjusted accordingly. Entries recorded in the stock records but not in the FIR accounts can result from one of two broad categories; 1. transaction information has not yet been made available to the accounting department (financially suspended

transactions) or 2. transaction information was recorded in the FIR account at a value different from that contained in the stock record transaction listing. The latter case appears more likely when both systems have remaining transaction entries that are unreconciled. It is then up to the accounting department to track down the transaction documentation and make the necessary adjustments.

When differences are a result of differences in the values recorded in each system, then the FIR is brought into balance by making the proper entry to a financial adjustment account that identifies the reason for the error (usually price variance) or to the account incorrectly recorded (i.e. if an entry to FIR account A1 (Receipts from Procurement-Commercial) is improperly recorded then adjustment is made to that account). When differences are a result of documentation not arriving in the accounting department, then the documentation is obtained and the out of balance FIR account is adjusted accordingly. Using the same example, if documentation is not available for a receipt from a commercial source then the data is obtained and FIR account A1 is adjusted accordingly.

Entries that are recorded in the FIR accounts but not in the stock records are usually an indication of improper recording in the system and are adjusted as described above. It is rarely the case that the stock record system is out of balance and even then it is impossible

to identify at the time of reconciliation. Any errors that do occur are normally corrected and recorded correctly in each system through physical inventory adjustments. Any differences between the two systems that remain after this process are accounted for as accounting adjustments. If the reconciliation process is performed correctly, the value of these adjustments should be minimal. However, as discussed previously, this is not always the case. The next section explores the reasons for these and other differences.

3. Problems Experienced with the Reconciliation Process

The major problem with the reconciliation process discovered by the Naval Audit Service was the large value of unsupported money value only transactions necessary to bring the systems into balance. In essence, unsupported money value only transactions are accounting adjustments that should have been recorded as adjustments to another FIR account. This type of error represented 79% of the value of all errors discovered by the audit service. [Ref. 6: p. 10] This would indicate that the activity is not able to identify the reasons that differences exist as the reconciliation process occurs. Expediency would appear to be the major contributing factor. It must be remembered that the personnel conducting the reconciliation process are working under a time constraint. They must have the process completed and the reports submitted in a certain period of time. Any differences that are not readily identifiable are

therefore processed as accounting adjustments for the sake of time. Since the audit service was not constrained by such a time factor, it was able to probe the system in depth and identify many reasons for differences that had eluded the activity during the reconciliation process.

4. Summary of Conclusions on Integrity and Financial Safeguards

It would appear then that the present FIR structure prohibits the timely recognition required for an accurate reconciliation process. Various reasons exist that contribute to this situation, the most significant being the level of detail at which the FIR is maintained and the reconciliation process is conducted. At the present time the process is conducted by comparison of inventory values at the condition code/material control code combination level. This entails comparison of a significant number of account totals just to identify any differences occurring within the system. Therefore, it is time consuming just to identify differences that require reconciliation. Once these differences are identified, they are put through the reconciliation process as discussed above. Since there are an enormous number of accounts maintained at the material control code/condition code combination the isolation and reconciliation of differences becomes an almost impossible task. In addition, this level contributes to a large portion of unreconciled differences through financial suspension of transactions

between the stock records and the financial inventory accounting system. It would therefore appear that maintenance of the FIR accounts and the processing of the reconciliation at the cognizance symbol level would greatly alleviate this problem.

In its simplest form, only three FIR coded accounts would be required to conduct the reconciliation process; 1. Receipts, 2. Issues, and 3. money value only transactions. As the discussion of Chapter 3 indicated, this extreme level of simplification is impossible if the requirements of the system prescribed by DOD regulations are to be maintained. However, any reduction in the number of accounts would improve the efficiency of the reconciliation process because there would be less accounts in which to create and consequently search for occurring differences. Therefore the conclusions of Chapter 3 for FIR coded account reduction would also assist in improving the efficiency of the reconciliation process.

The remaining problems identified by the audit dealt mainly with personnel errors. Invalid adjustments represented 3% of the value of errors identified. These invalid adjustments represent transactions that have previously been adjusted prior to the reconciliation process. Improper FIR code usage represented 8% of the value of errors identified. Unreconciled differences accounted for the remaining 10% of the errors noted by the audit. These differences represent

situations where differences were either not reconciled or done so improperly. [Ref. 6: pp. 10-11] In all three cases, simplification of the system should permit a better understanding by operating personnel and thus lead to greater efficiency.

The conclusion then is that, in theory, the present FIR structure should be quite capable of meeting its requirements for the maintenance of inventory integrity through financial safeguards. In practice, however, it falls extremely short of meeting its goals. The major factors that contribute to this failure are the complexity of the present FIR structure and the necessity for expediency in the reconciliation process. Simplification of the system is a way that the effectiveness of the FIR in fulfilling this requirement can be improved. It would not appear reasonable due to DOD governing regulations, to simplify the FIR structure to the level maintained by the stock record maintenance system. However, the simplification discussed in Chapter 3, should significantly improve the FIR's effectiveness in fulfilling this requirement.

C. PROVIDING FINANCIAL DATA FOR BUDGETARY REQUIREMENTS

1. General

The budget process for DOD activities has evolved into a large and complicated process over the years. The submission for the Navy Stock Fund for fiscal year 1983

alone contained over 360 pages of budget data and supporting justification. [Ref. 8] As stated in Chapter 3, many of the reports derived from the information in the chart of accounts are utilized during the budget submission process. The format of many of these reports, particularly the inventory status and transaction statement and the reimbursable issues statement, is utilized to develop the details of and provide justification for the budget submission. It would therefore appear that the format for submission of budgetary requirements is tied very closely to the format required in the chart of accounts. This is in fact so and seems reasonable when one considers that both budgetary and accounting requirements are issued from the same section of the office of the Secretary of Defense.

Although the budget submission is indeed a long and detailed piece of work for each submission, it does not seem necessary or desirable to deal with that level of detail in the analysis of the FIR reporting structure. Rather it appears satisfactory to simply analyze the basic budget documents for each type of inventory account. Although the Navy Stock Fund and the Appropriation Purchases Account are two distinct and quite different inventory accounts, similar budget justification systems exist for each. The basic budgetary document for the stock fund is the operating budget statement, as illustrated in Figure 4.1. [Ref. 8: pp. 9-14] Figure 4.2 is an example of the spares and

repair parts operating budget which is the basic budget document utilized by the appropriation purchases account.

[Ref. 2: pp. 3-4]

NAVY STOCK FUND OSD/OMB FY83 BUDGET SUBMISSION		
MATERIAL REQUIREMENTS	FY 1983	
	Approved	Proposed
1. INVENTORY ACQUISITION AND ON ORDER OBJECTIVES END OF PERIOD		
a. Peacetime asset objective	5712.1	6041.6
b. Total mobilization acquisition	1057.1	1393.3
c. Less: balance mobilization requirement	693.4	1005.5
d. Mobilization acquisition protectable	363.7	387.8
e. Total objective (a and b)	6075.8	6429.4
2. MATERIAL USAGE:		
a. Reimbursable issues (net)	5090.7	5003.5
b. Sales Credit and allowances	82.0	77.1
c. Total issues	5172.7	5080.6
3. TOTAL MATERIAL REQUIREMENTS	11248.5	11510.0
LESS MATERIAL AVAILABILITY		
4. INVENTORIES APPLICABLE AT BEGINNING OF PERIOD:		
a. Peacetime stock	1396.7	1442.2
b. Mobilization acquisition-protectable	192.8	192.8
c. In-transit and other stocks	101.8	101.8
5. INVENTORY INCREASES AND DECREASES DURING PERIOD APPLICABLE	952.2	988.3
6. TOTAL INVENTORIES APPLICABLE	2643.5	2725.1
7. NET REQUIREMENT AT STANDARD PRICE	8605.0	8784.9
a. Less: credits, allowances on purchases and receipts under capitalized contracts	142.5	231.7
b. Less: Unfunded requirements	-	285.5

Figure 4.1 Operating Budget Statement

8.	NET FUNDED REQUIREMENTS AT STANDARD PRICE	8462.5	8267.7
a.	Less: Surcharges and Purchase Variances	558.6	348.9
9.	REQUIREMENTS AT COST	7903.9	7918.8
10.	MATERIAL ON ORDER		
a.	End of period (memo)	2360.8	2358.1
b.	Beginning of period applicable (-)	1738.1	1822.6
c.	Beginning of period inapplicable (memo)	117.7	149.1
11.	TOTAL PROCUREMENT REQUIREMENT	6165.8	6096.2
12.	ADD OTHER OBLIGATION REQUIREMENTS		
a.	Transportation costs	14.9	14.9
b.	Repair costs	120.7	109.4
c.	Other costs	78.3	77.5
d.	Contracts and orders out- standing for repair of stocks, increase (+) or decrease (-)	-	-
e.	Total other obligation require- ments	213.9	201.8
13.	TOTAL FISCAL YEAR PROCUREMENT REQUIREMENT	6379.7	6298.0
14.	LESS: COMMITMENTS AT COST END OF PERIOD	514.6	400.3
15.	TOTAL PEACETIME OBLIGATION REQUIREMENTS	5865.1	5897.7
16.	BALANCE MOBILIZATION RESERVE REQUIREMENT:		
a.	Requirement	693.4	1005.5
b.	Assets	9.9	19.1
c.	Net requirement at standard price	683.5	986.4
d.	Net requirement at cost price	620.8	946.5
e.	Funds requested	.3	.3
17.	TOTAL FISCAL YEAR OBLIGATIONS	5865.4	5898.0

Figure 4.1 Contd.

The purpose of the budget submission is to determine the stock level requirements of the coming fiscal year for each inventory account; offset these requirements with assets already on hand or on order to determine the amount of procurement that will be necessary to maintain that level, the amount of reimbursement attainable from issues, and the amount of funding necessary to meet the requirements (or flows) of the account must be considered in order to forecast and in some cases request cash infusions. In the case of the APA account, the forecasted amount of procurement must be adjusted by anticipated reimbursables in order to determine the net direct funding required. Both types of accounts share these objectives in common. Although the Stock Fund itself is a revolving fund, the inventory managers, and indeed the Stock Fund itself, must still obtain permission to obligate funds on an annual basis. The budgetary process provides the vehicle for submission and approval of the required obligational authority.

In determining how effectively the FIR is able to meet its objective of providing inventory managers with budgetary data, one must first identify the format and the type of information that the system should be able to provide to the budgetary process. From this point the ability of the system to provide that data in a readily identifiable manner can be determined. The level at which the information is required must also be identified and

compared with the level provided for by the reporting system. In essence, the measure of effectiveness of the FIR to fulfill its budgetary requirements is the ease in which FIR data can be identified and put to use in the budgetary process.

2. The Budgetary Process

The basic budget documents for both types of inventory accounts are illustrated in Figures 4.1 and 4.2. The budget for each account is built from the bottom up by supported submissions from inventory managers. These submissions are grouped by material cognizance managed by an Inventory Manager into Budget Projects. For instance, budget project 34 within the Navy Stock Fund indicates the budget submission by ASO for NSA material cognizance 1R and 5R. The FIR data for each cognizance symbol is then summed to arrive at the budget base data for each budget project. Each project is in turn summed to arrive at the overall budget submission for each inventory account. [Ref. 8: pp. 14-1-14-50] It would therefore appear that the FIR could be maintained at the cognizance symbol level and still be able to provide the core information necessary for construction of and comparison with budget submissions.

The FIR provides data to the budgetary process by providing actual historical data based upon past submissions. This historical data is utilized to provide forecasts of budgetary information that will appear in the FIR in future

**NAVY APA SPARES AND REPAIR PARTS FUNDS FY83 OSD/OMB
BUDGET SUBMISSION**

MATERIAL REQUIREMENTS

**FY 1983
Approved Proposed**

1. INVENTORY ACQUISITION AND ON ORDER OBJECTIVES END OF PERIOD		
a. Peacetime Asset Objective	49,599	49,242
b. Total Mobilization Acquisition		
c. Less: Balance Mobilization Requirement		
d. Mobilization Acquisition Protectable		
e. Total Objective (a and b)	50,497	49,599
2. MATERIAL USAGE:		
a. Reimbursable Issues (net)		
b. Non Reimbursable Issues	41,436	34,511
c. Total Issues	41,436	34,511
3. TOTAL MATERIAL REQUIREMENTS LESS MATERIAL AVAILABILITY	91,053	83,753
4. INVENTORIES APPLICABLE AT BEGINNING OF PERIOD		
a. Peacetime Stock	57,450	54,514
b. Mobilization Acquisition Protectable		
c. In-Transit and Other Stocks		
5. INVENTORY INCREASES AND DECREASES DURING PERIOD APPLICABLE	18,519	11,062
6. TOTAL INVENTORIES APPLICABLE	79,969	65,576
7. NET REQUIREMENTS	15,066	18,177
a. Less Unfunded Requirements		
b.		
8. NET FUNDED REQUIREMENTS	15,066	18,177
9. MATERIAL ON ORDER		
a. End of Period (Memo)	5,717	6,645

Figure 4.2 Financial Program Objectives

b. Beginning of Period- Applicable (-)	6,290	7,286
c. Beginning of Period- Inapplicable (Memo)	0	0
10. TOTAL PROCUREMENT REQUIREMENT	8,776	10,891
11. BALANCE MOBILIZATION RESERVE REQUIREMENT:		
a. Requirement		
b. Assets		
c. Net Requirement		
d. Funds Requested		
12. TOTAL PROCUREMENT AUTHORITY	8,776	10,891
13. DISTRIBUTION OF PROCUREMENT AUTHORITY:		
a. Obligations Initial Spares		10,891
b. Obligations Replenishment Spares	7,347	8,679
c. Commitments End of Period	1,529	2,212

Figure 4.2 Contd.

periods as the budget is carried to completion. For example, the budgetary data contained in Figure 4.1 are merely forecasts of future FIR data since the budget was built significantly prior to Fiscal Year 1983. In addition, the FIR report provides actual data on current transaction balances that is utilized for comparative purposes to establish the accuracy of the budget.

In order to understand the type of information that the FIR needs to provide to the budgetary process one must first understand how the basic budget document is constructed and where the data is obtained. Since both inventory accounts are relatively similar, it is sufficient

for the purposes of this thesis to simply analyze one. Since the budget submission is slightly more complex for the stock fund, the analysis will deal with the budget submission as illustrated in Figure 4.1.

The budget is divided into 3 separate categories; Material Requirements, Material Availability, and Net Requirements. In its simplest form, the material requirements less the material already on hand or on order yields the requirements of the account. The Material Requirements section is further divided into; Inventory Acquisition and on order objectives for the end of the period and Material usage. The amount of inventory contained within the acquisition and stocking objective is essentially the amount of inventory desired either on hand or on order at the end of the accounting period. It consists basically of Peacetime asset objectives (1a) and prepositioned war reserves (1b-1d). Prepositioned war reserves are determined and funded by higher authority and do not utilize any FIR related data. The peacetime objectives are determined through a detailed analysis and computation. In essence, this analysis is a forecast based upon past experience and future known requirements. Gross sales, Issues, and transfers are determined for both first and second echelons of supply. Then safety levels, acquisition lead time, and procurement cycles are estimated and their effects on the stocking objective calculated. Finally, the effects of

other stockage objectives, such as tender loads and initial spares are calculated. The combination of the material requirements for safety levels, acquisition lead time, procurement cycles and special objectives are then combined to determine the peacetime asset objective. Essentially, this figure will be that value of material desired to be on hand or on order by the end of the period that does not deal with prepositioned war reserves.

It would appear that data contained within the financial reporting system should be capable of conversion into sales, issues, and transfers at both echelons of supply for forecasting and comparative purposes dependent upon the specific situation in which the FIR is being utilized in the budgetary process. The basic requirements for first echelon supply points can be found by summarizing all issue and transfer information for each cognizance symbol maintained and submitted at the activity level for main store operations. The level of detail presently utilized by the FIR structure is not necessary. Second echelon of supply information is available from two separate sources. First, the special accounting classification discussed in Chapter 2 are compiled to provide the bulk of second echelon information. In addition, the inventory adjustment accounts D3 (Receipts without Reimbursement--Servmart Material) and M3 (Issues without Reimbursement--Servmart Material) also provide information on material utilization at the second echelon level.

The Material usage section attempts to forecast the amount of material that will be required by customer activities based upon past experience provided by the FIR. It consists of a prediction of the total reimbursable issues as well as all sales credits and allowances. The data necessary for this forecast is readily available from the FIR and is, in fact, in greater detail than required by the budgetary process. This forecast is then summarized with the peacetime asset objectives and the stockage objective for prepositioned war reserves to yield total material requirements of the period.

The next section of the budget deals with the material on hand that is available to meet the requirements as calculated above. It is divided into two sections; inventories applicable at the beginning of the period and inventory increases and decreases of the period. The total beginning inventory as reported by the FIR will be equal to the total of (4a) and (4b) Peacetime Stock and Mobilization Acquisition-Protectable, which deals with prepositioned war reserves. The value of in-transit material is obtained from the central accounts as described in Chapter 3.

The entry entitled Inventory increases and decreases during the period-applicable is an attempt to adjust the value of the material on hand for the value of changes that will occur to the inventory during the period. This value may be taken directly from statement 4a, Inventory Status

and Transaction Statement, which is a chart of account statement illustrated in Figure 3.8. Statement 4a is utilized in the budgetary process in two ways; it is utilized to report historical data from the chart of accounts and it is utilized as a forecasting document to determine the effect of future transactions upon the value of inventory. In this case it is utilized as a budget forecasting document utilizing information contained within historical statements of the same title. As shown in Figure 3.8, this entry adjusts the material on hand for; capitalized inventories, material returns from customers for credit, material returns without credit and receipts of material without charge, standard price changes, transfers to property disposal, issues without reimbursement, inventories decapitalized, other gains and losses, and transfers between strata. As discussed in Chapter 3, all of these categories, with the exception of transfers between strata, are readily available through the present system. Since these categories have already been subjected to analysis in Chapter 3, no further analysis is offered at this point. A word of explanation is, however, necessary concerning the category entitled "transfers between strata." This category lists the value of material transfers between inventory strata for the period. In its simplest form, stratification refers to the identification of applicability of material to the budgeted purpose for a given budget period. This

category then identifies transfers that occur as a result, such as transfers from peacetime stock to prepositioned war reserves or recategorization of previous "excess" stock to a usable against the budget requirement.

The material requirements are then adjusted by the amount of total applicable inventories to arrive at the net requirements of the budget at standard cost. These requirements are then adjusted as shown in Figure 4.1 to arrive at the total obligation requirements of the period. This figure is in effect the budget request for the applicable budget project or inventory account depending upon which level the budget submission is being made.

3. Summary of Conclusions on Budgetary Requirements

Essentially there is not a great deal of difference between the requirements for providing budgetary information and the governing regulations discussed in Chapter 3. The present structure of the FIR is extremely capable of fulfilling these requirements in an effective manner. However, just as its other objectives, the budgetary process does not require the level of detail that is maintained by the present structure. It is necessary simply to identify broad categories of information, such as reimbursable issues, transfers, capitalized inventories, and issues without reimbursement at the cognizance symbol level. Thus it would appear possible that the FIR structure could be

greatly simplified without any detrimental effects upon the budgetary objectives of the system.

Chapters 3 and 4 have attempted to summarize and analyze the major objectives of Financial Inventory Accounting and Reporting within the Naval Service. As shown throughout this analysis the present FIR structure is a great deal more complex than is necessary to fulfill these objectives. This complexity has, in turn, led to a number of the existing problems inherent within the system. Simplification of the existing system is not only possible but necessary if the FIR is to continue to function as a viable means of providing financial information on the Navy's inventory accounts. Chapter 5, then, will summarize the conclusions of the preceding analysis and offer a proposed system for adoption.

V. SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

A. GENERAL

The logical conclusion of the foregoing analysis is that the present structure of Financial Inventory Reporting within the Naval Service must be reduced in its complexity. However, before any attempt is made at the development of a simpler structure, it is helpful to understand some of the reasons the FIR structure became as complex a system as it is today. In order to accomplish this, one must first be able to visualize the circumstances under which the system was developed.

As discussed in Chapter 2, the FIR was developed from the requirements of the National Security Act of 1947. At that time, the present automated stock record management systems utilized today were beyond the wildest dreams of inventory managers. Essentially any inventory monitoring that was accomplished was performed manually and was indeed quite time consuming. Since the act specified that both stock level and financial records were to be maintained both systems were indeed maintained at the activity level. However, the only system subject to reporting by activities was the financial records which were reported to a central accounting office in much the same manner that is utilized in today's system. Under a manual inventory accounting

system no real attempt could be made at the activity level to reconcile the information within the two systems. Since the financial reports were the only available means of information to centralized inventory managers on the level of stock at various activities, it was necessary for the reports to carry inventory monitoring information needed by these inventory managers. Thus, the reports were structured to provide information on the value of inventory in various condition codes and material control codes. From this information managers were able to make reasonable estimates as to the total value, condition, and movement of inventory levels under their cognizance.

Automation changed the complexion of the system in two distinct ways. First, management information previously taken from FIR reports on condition and material control codes categories is now instantaneously available to inventory managers through the automated stock record maintenance system. Second, the automation of both systems identified a need to reconcile any differences between the two. The initiation of this reconciliation process identified the first problems with the present FIR structure. The complexity of the FIR structure itself is often the cause of these problems, as discussed in Chapter 2.

Automation also changed the overall structure of the reporting system itself. Prior to the advent of computers

into the supply system both functions, monetary banking and inventory maintenance, were performed and posted at the activity level. Transaction reports were made to the central accounting office on a periodic basis only. Thus, the activities' FIR report was required to be in a format that would satisfy both monetary and inventory accounts required by the chart of accounts. However, with automation the monetary system has since developed into a semi-centralized structure with banking transactions posted and reported from a Financial Information Processing Center in automated format. It is therefore no longer necessary for the format of the FIR report to provide the central accounting office with such a complete level of detail.

From this brief discussion, one can easily see how the system that exists today has developed. The conditions that are responsible for a portion of the structure, however, no longer exist and only serve to add to its complexity and the degree of difficulty experienced in the maintenance of the system in its present form. The thrust of this thesis has been to identify areas where the system could thus be simplified in today's environment without any detrimental effects upon the structures ability to perform its stated objectives. The conclusions and recommendations discussed in Chapters 3 and 4 were developed in light of this goal. The remainder of this chapter will outline a proposed system, based upon those conclusions, that would still

enable the functions of Financial Inventory Reporting to be fulfilled while significantly simplifying the system.

B. PROPOSAL FOR REVISED FINANCIAL INVENTORY REPORTING STRUCTURE

First and foremost, the reports should be structured at the cognizance symbol level. This one concept will do more to simplify the system than anything else discussed hereafter. The necessary management information contained at the condition code/material control code level is already provided to inventory managers by the stock record maintenance system. In addition, nowhere within the stated objectives of the FIR is the information at this level utilized. It would therefore appear that maintenance of information at this level serves no useful purpose and merely acts to complicate the system.

In addition to the above alteration, many opportunities exist within the FIR coding structure that offer a means to simplify the system through a reduction in the number of FIR coded accounts. A few cases also exist where changes in reporting procedures are desirable in order to more accurately reflect the value of information reported by the accounts. These changes will be discussed in the following sections in the same order as the original discussion of the FIR contained in Chapter 2. Areas where no alteration is

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enable the functions of Financial Inventory Reporting to be fulfilled while significantly simplifying the system.

B. PROPOSAL FOR REVISED FINANCIAL INVENTORY REPORTING STRUCTURE

First and foremost, the reports should be structured at the cognizance symbol level. This one concept will do more to simplify the system than anything else discussed hereafter. The necessary management information contained at the condition code/material control code level is already provided to inventory managers by the stock record maintenance system. In addition, nowhere within the stated objectives of the FIR is the information at this level utilized. It would therefore appear that maintenance of information at this level serves no useful purpose and merely acts to complicate the system.

In addition to the above alteration, many opportunities exist within the FIR coding structure that offer a means to simplify the system through a reduction in the number of FIR coded accounts. A few cases also exist where changes in reporting procedures are desirable in order to more accurately reflect the value of information reported by the accounts. These changes will be discussed in the following sections in the same order as the original discussion of the FIR contained in Chapter 2. Areas where no alteration is

desirable, such as Opening and Closing Inventories, will be omitted from the discussion.

C. RECEIPTS

1. Receipts from Procurement

The procedures presently utilized for receipts from procurement are illustrated in Figure 2.3. As shown there, three separate accounts are utilized to report receipts from procurement.

- A1 Receipts from Procurement-Commercial
- A3 Receipts from Procurement-other DOD agencies
- A5 Receipts from Procurement-other

Since the primary reports of receipts from procurement are from the monetary reporting system, the FIR report need not maintain the level of detail necessitated by the chart of accounts on procurement source. The only distinction which appears to be required is identification of receipts at both purchase price and standard price in order to reconcile with the information contained within the expense accounts.

Therefore the only receipt accounts necessary would be;

- A1 Receipts from Procurement-at Purchase Price
- A3 Receipts from Procurement-at Standard Price

Returned material is presently reported with the same source of procurement information as its original receipts.

- A2 Receipts from Procurement-Material Returns-Commercial
- A4 Receipts from Procurement-Material Returns-other DOD agencies

A6 Receipts from Procurement-Material Returns- other

However, nowhere within the system is this information utilized. Here again, the primary source of this information is gained from the monetary reporting system. Therefore, these three accounts could be replaced with one single account for material returns.

A4 Receipts from Procurement-Material Returns

The remaining reconciliation procedures for receipts from procurement illustrated in Figure 2.13 remain valid with one exception. As discussed in Chapter 3, when matching differences occur in procurement sources other than commercial they are corrected utilizing standard price adjustments vice price variance accounts. This procedure tends to reflect inaccurately the ending balance in each account. Therefore, all matching differences should be reported as price variances regardless of the source of procurement.

It must be remembered that the main purposes of receipt from procurement information are; to adjust the value of inventory levels for receipts as appropriate and to provide total values for reconciliation with expense accounts which obtain their primary data from the monetary accounting system. For this reason it appears that the accounts need not be as complicated as presently utilized.

The seven receipt from procurement accounts (A1-A6 plus A8) could be reduced to a total of four.

2. Transfers from other Supply Officers

Transfers from other Supply Officers are illustrated in the procedures outlined in Figure 2.4. Two separate account categories are identified for utilization in reporting these transfers.

F4 Transfers from other Supply Officers-Stock Transfers
F5 Transfers from other Supply Officers-other

The purpose of separating these two types of transfers is to segregate stock transfers from transfers obtained for immediate issue by the activity. However, at no point within the system does it appear that the information derived by this segregation is put to use. The use of two separate accounts is questionable. Therefore, all transfers from other supply officers could be debited to one single account entitled "Transfers from other Supply Officers."

3. Receipts from Returned Material

Receipts from returned material is one of the most complicated structures within the FIR reporting system as illustrated in Figure 2.5. However, a number of opportunities exist that could simplify the structure. The first opportunity deals with elimination of the suspense credit system utilized when material is received by one activity that belongs to another. As stated in the original discussion in Chapter 2, these three accounts (BB, BC, and BD) have already fallen into disuse by virtually all field

activities. However, the solution is not simply to maintain off ledger balances as presently done. Instead, either ownership should be taken by the receiving activity and a credit decision made at that point or the material should be returned to the owning activity. With the exception of DLR material, it would appear to be a rare instance when an activity would be unable to take ownership of the material in question.

The structure for posting receipts of material returns can also be simplified to a certain degree. The separate reporting of accounts J2 (Issues with Reimbursement--Returns--Service Use) and J4 (Issues with Reimbursement--Returns--Other than service use and MAPS) is an attempt to separate material returns in the same manner as identified by the original issue of the material. This separate reporting, however, does not appear to be required by any regulation or objective of the system and could be combined effectively into a single account entitled J2 (Issues with Reimbursement--Returns).

In addition, the segregation of the return of APA material utilizing accounts B5 (Receipts without Reimbursement--other) when material credit is not granted for issues from other than DOD activities and A5 (Receipts from Procurement--other) when material was originally purchased for end use is highly misleading. The proper accounting entries should be posted to accounts B1 (Receipts without Reimbursement--Return

of Material from users) and J2 (Issues with Reimbursement--Returns) (as revised above) respectively. All other procedures outlined in Figure 2.5 should remain as illustrated. The overall effect of the above procedural modifications would reduce the number of FIR coded accounts by four.

4. Receipts without Reimbursement

Receipts without reimbursement are illustrated in Figure 2.6. Under the present structure six separate FIR accounts are utilized to report the value of receipts without reimbursement.

- B1 Receipts without Reimbursement-Return of Material from Users
- B2 Receipts without Reimbursement-Intraservice
- B3 Receipts without Reimbursement-NSA DLR Exchange program
- B4 Receipts without Reimbursement-Capitalization
- B5 Receipts without Reimbursement-other
- B9 Receipts without Reimbursement-other retail activities

In contrast with Receipts from Procurement, the structure utilized for Receipts without Reimbursement must provide all subsidiary information as outlined by the chart of accounts. Therefore, the FIR structure must be able to indicate information on source of receipt. In essence, all the above accounts are necessary in order to fulfill some form of reporting requirements as discussed in Chapter 3. Therefore, no reduction in the above listed accounts is possible. However, many other accounts can be combined and included into account B9 which reports the value of all interservice receipts without reimbursement that do not have

other overriding reporting requirements. The FIR accounts that are listed under other titles in Chapter 2 but which essentially are receipts without reimbursement and could therefore be contained in account B9 are as follows:

- C1 Receipts from property disposal
- C2 Receipts from property disposal-reclamation

Adoption of this proposal would eliminate an additional two FIR coded accounts.

5. Receipts from Property Disposal

At the present time two accounts are utilized to report receipts from property disposal.

- C1 From Property Disposal
- C2 From Property Disposal-Reclamation

The separation of these two accounts originated in order to provide inventory managers with information necessary when planning their procurement cycles. However, as discussed in the introduction to this chapter, the FIR structure is no longer the primary source of this information. Therefore, the two accounts could be combined into one account that reflects all receipts from transactions involving property disposal organizations. As indicated in the previous section, an even better solution is to combine all property disposal receipts into a interservice receipts without reimbursement account.

D. EXPENDITURES

1. Issues with Reimbursement

The present structure in use for reporting on the values of issues with reimbursement is illustrated in Figure 2.7. As shown in that figure, three accounts are utilized to record issues with reimbursement.

- J1 Issues with Reimbursement-Service use
- J3 Issues with Reimbursement-other than Service use and MAPS
- J5 Issues with Reimbursement-MAPS

As discussed in Chapter 3, the segregation of these three accounts is an attempt to report issue information at the same level of detail maintained for receipts (i.e. segregation of intraservice and interservice transactions). However, this level of detail is not required. It must be remembered that the detailed information necessary for reporting Issues with Reimbursement is obtained from the monetary reporting system. Therefore, the information from the FIR structure need only be in summary form for use in the reconciliation process. It would appear beneficial, then, to combine the three accounts into one single account.

The inclusion of J5 into the account described above may seem impractical on the surface, considering it is a special account utilized by NAVILCO. NAVILCO is the activity that monitors and accounts for all transactions that occur as a result of the Military Assistance Grant Aid Program. J5 merely reports the value of Issues made under

this program. At no place within the FIR objectives does this information appear to be utilized. If desired for whatever reason, the same information could be obtained from the combined code utilized by NAVILCO in much the same manner that information on inventories with contractors is obtained from SPCC and ASO FIR reports. This would be possible because the only issue transactions reported by NAVILCO will be of this type.

Figure 2.7 also portrays two contra issue accounts utilized to report material returns. As discussed earlier, these two accounts, J2 (Issues with Reimbursement--Returns--Service use) and J4 (Issues with Reimbursement--Returns--other than Service use and MAPS), should be combined into one material returns account for the same reasons as discussed above. Adoption of this portion of the proposal will reduce the five accounts presently utilized to report issues with reimbursement to two.

2. Issues without Reimbursement

Nine issue accounts and two contra issue accounts are presently utilized by the FIR to report on the value of Issues without Reimbursement as illustrated in Figure 2.8.

The issue accounts are as follows:

- K1 Issues without Reimbursement-Service use
- K3 Issues without Reimbursement-Intraservice
- K5 Issues without Reimbursement-Decapitalization
- K6 Issues without Reimbursement-MAP-Grant Aid
- K7 Issues without Reimbursement-Material Returns
- K8 Issues without Reimbursement-other

K9 Issues without Reimbursement-other retail activities

KB Issues without Reimbursement-Retail to Wholesale activity

KD Issues without Reimbursement-Service use

Since the FIR structure provides the only available information on Issues without Reimbursement then the accounts utilized must provide all the information required by the Chart of Accounts. Therefore, the account structure must segregate type as to "inter" and "intra" service. For this reason accounts K1, K3 and K6 are necessary. Accounts K5 and K7 provide information necessary for reporting purposes other than those that directly effect Issues without Reimbursement. It would appear then, that the first five accounts are a necessary part of the structure. However, accounts K8, K9, KB, and KD are interservice accounts that identify the type of transaction involved such as issues from retail to wholesale activity. This level of detail is well beyond that required by the chart of accounts. In addition, the detail does not appear to be required at any other level such as decapitalization. Therefore, these four accounts could be included into account K1, thus reducing the nine issue accounts to five.

The two contra issues accounts, K2 (Issues without Reimbursement--Returns--Service use) and KE (Issues without Reimbursement--Returns--Service use), separate returns that were originally issues under accounts K1 and KD which would be combined if the above proposal is adopted.

It would therefore seem logical that these two accounts should be combined also, which is in fact the case. However, it is helpful to understand just why these two types of issues and returns were reported separately in the first place. The purpose of separating the two accounts was to identify that portion of issues without reimbursement that were subjected to statistical costing. As discussed in Chapter 2, statistical costing procedures charge the cost of the issue to a job, unit, or appropriation on a statistical basis, without any subsequent charge to or reimbursement from the appropriation involved. Since this information does not appear to be utilized under the objectives of the FIR, and is indeed available from the monetary accounting system, it would appear unnecessary to maintain it within the FIR structure. Adoption of the entire proposal discussed above will reduce the number of FIR coded accounts for issues without reimbursement from eleven to seven.

3. Transfers to other Supply Officers

As with transfers from other Supply Officers, transfers to other Supply Officers are placed in two separate categories.

P4 Transfers to other Supply Officers-stock transfers
P5 Transfers to other Supply Officers-other

This need to separate transfers for stock from those for immediate use is just as non existent in this case as it was for transfers from other Supply Officers. Therefore, the

proposal would call for the combination of these accounts into a single "Transfers to other Supply Officers" account.

4. Expenditures as a Result of Returned Material

Expenditures as a result of material returned by an activity is illustrated in Figure 2.9. The major changes to that illustration will result because of combinations or modifications discussed in previous sections. The only major procedural change will occur under the portion entitled material returned from inventory, credit not allowed. The use of account K8 (Issues without Reimbursement--other) for material returns originally issued under A5 misstates the value of material returns. In addition, there is no need for accounts K8 and A5 as separate accounts. Therefore all material returns, where credit is not allowed, should be credited to account K7 (Issues without Reimbursement--Material Returns).

The other change from the procedures contained in Figure 2.9 concerns the combination of the contra receipt account A2, A4, and A6. As discussed under the Receipts from Procurement Section, these three accounts should be combined into a single account entitled "Receipts from Procurement-Material Returns." Therefore, any place in Figure 2.9 that these three accounts appear, either separately or together, should be replaced with this combined account. All other procedures illustrated in Figure 2.9 remain valid.

E. RECATEGORIZATION/REVALUATION/PHYSICAL ADJUSTMENTS

1. Inventory Adjustments

The procedures discussed to this point will allow the elimination of four Inventory adjustment accounts. Maintenance of the system at the cognizance symbol level relieves the structure of any burden to transfer inventory between condition codes and material control codes. Therefore, the Inventory adjustment accounts listed below can be eliminated from the FIR structure.

- D1 Inventory Adjustments-Gains-Condition Transfers
- D2 Inventory Adjustments-Gains-Material Control
Code Transfers
- M1 Inventory Adjustments-Losses-Condition
Transfers
- M2 Inventory Adjustments-Losses-Material Control
Code Transfers

2. Financial Adjustments

No obvious eliminations of accounts are possible under this section. However, as discussed in Chapter 3, the information at the activity level concerning the value of inventory in process of assembly/disassembly is inadequate and in most cases non existent. Therefore, it would seem that an account should be established to maintain the value of this type of inventory at the activity level. This account could be debited and credited with the values as contained in the assembly/disassembly transactions contained in accounts E5 and N5.

F. CONCLUSION

It has been the intent of this thesis to analyze the present Financial Inventory Reporting structure in the light of how effectively that structure is able to meet its stated objectives. Ever since the completion of the Naval Audit Service's report in 1979 the FIR has been the topic of a great deal of debate, conjecture, and analysis within the Naval Service. The underlying theme behind both this debate and the audit service's report identified a distinct need to simplify the system. The analysis of the preceding chapters proved this need and offered areas where this simplification could be put into effect. The proposal described above is an attempt to derive a simpler system based upon the concepts discussed during the analysis of Chapters 3 and 4. This system should, in theory, be able to eliminate many problems inherent in the present structure. It is highly recommended that the Navy explore the initiation of many of the concepts described heretofore in the hope of developing a worthwhile system for Financial Inventory Accounting and Reporting.

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